



# **William Marsh Rice University**

**Consolidated Financial Statements**

**June 30, 2016 and 2015**

**William Marsh Rice University**  
**Index**  
**June 30, 2016 and 2015**

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## Report of Independent Auditors

To the Board of Trustees of  
William Marsh Rice University:

We have audited the accompanying consolidated financial statements of William Marsh Rice University (the "University"), which comprise the consolidated statements of financial position as of June 30, 2016 and 2015 and the related consolidated statement of activities for the year ended June 30, 2016, and consolidated statements of cash flows for the years ended June 30, 2016 and 2015.

### ***Management's Responsibility for the Consolidated Financial Statements***

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

### ***Auditors' Responsibility***

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

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

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of William Marsh Rice University as of June 30, 2016 and 2015, and the changes in its net assets for the year ended June 30, 2016 and its cash flows for the years ended June 30, 2016 and 2015 in accordance with accounting principles generally accepted in the United States of America.



***Other Matter***

We previously audited the consolidated statement of financial position as of June 30, 2015, and the related consolidated statements of activities, and cash flows for the year then ended (not presented herein), and in our report dated October 26, 2015, we expressed an unmodified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying summarized financial information as of June 30, 2015 and for the year then ended is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

*PricewaterhouseCoopers LLP*

October 21, 2016

**William Marsh Rice University**  
**Consolidated Statements of Financial Position**  
**June 30, 2016 and 2015**

(in thousands of dollars)

	2016	2015
<b>Assets</b>		
Cash and cash equivalents	\$ 27,054	\$ 13,896
Cash of consolidated endowment investments	43,862	111,924
Total cash and cash equivalents	70,916	125,820
Accounts receivable and other assets, net	81,605	94,246
Pledges receivable, net	175,738	184,063
Investments	5,777,441	6,032,613
Property and equipment, net	1,284,450	1,190,319
Total assets	<u>\$ 7,390,150</u>	<u>\$ 7,627,061</u>
<b>Liabilities</b>		
Accounts payable and other liabilities	\$ 93,569	\$ 80,497
Liabilities of consolidated endowment investments	81,188	73,893
Notes and bonds payable	931,061	960,703
Actuarial liability for annuities payable	114,127	116,940
Government refundable advances	7,554	7,443
Total liabilities	<u>1,227,499</u>	<u>1,239,476</u>
<b>Net Assets</b>		
Net assets: Rice University	6,124,347	6,358,252
Net assets: Non-controlling interest	38,304	29,333
Total net assets	<u>6,162,651</u>	<u>6,387,585</u>
Total liabilities and net assets	<u>\$ 7,390,150</u>	<u>\$ 7,627,061</u>

	Unrestricted	Temporarily Restricted	Permanently Restricted	2016	2015
<b>Detail of net assets:</b>					
Internally designated	\$ 144,651	\$ -	\$ -	\$ 144,651	\$ 146,226
Restricted by donor	151,812	102,845	-	254,657	272,068
Net investment in plant	255,033	63,904	-	318,937	314,171
Endowment and designated for long-term investment	2,329,746	1,921,451	1,103,311	5,354,508	5,573,038
Life-income trusts	-	32,793	13,449	46,242	48,854
Student loans	2,450	-	2,902	5,352	3,895
Net assets: Rice University	2,883,692	2,120,993	1,119,662	6,124,347	6,358,252
Net assets: Non-controlling interest	38,304	-	-	38,304	29,333
Total net assets	<u>\$ 2,921,996</u>	<u>\$ 2,120,993</u>	<u>\$ 1,119,662</u>	<u>\$ 6,162,651</u>	<u>\$ 6,387,585</u>

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

**William Marsh Rice University**  
**Consolidated Statements of Activities**  
**Years Ended June 30, 2016 and 2015**  
**(With Summarized Financial Information for the Year Ended June 30, 2015)**

	2016			2015	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
<i>(in thousands of dollars)</i>					
<b>Operating revenues</b>					
Investment returns distributed for operations	\$ 151,327	\$ 115,106	\$ -	\$ 266,433	\$ 249,284
Student tuition and fees, net	162,949	-	-	162,949	148,227
Grants and contracts	135,177	-	-	135,177	127,076
Gifts and pledges	29,983	2,823	-	32,806	56,833
Gifts and trusts released from restrictions	104,483	(104,483)	-	-	-
Auxiliary enterprises	44,471	-	-	44,471	41,454
Other revenues	24,954	-	-	24,954	30,491
Total operating revenues	653,344	13,446	-	666,790	653,365
<b>Operating expenses</b>					
Salaries and wages	320,787	-	-	320,787	304,692
Benefits	77,927	-	-	77,927	71,186
Scholarships	20,003	-	-	20,003	19,077
Depreciation and amortization	68,414	-	-	68,414	67,080
Interest and bond costs	34,895	-	-	34,895	32,931
Utilities and rent	11,722	-	-	11,722	13,627
Other operating expenses	128,401	-	-	128,401	117,875
Total operating expenses	662,149	-	-	662,149	626,468
Net operating (loss) income	(8,805)	13,446	-	4,641	26,897
<b>Nonoperating changes</b>					
Gifts, grants, and pledges for property and endowment	8,770	23,909	21,010	53,689	75,493
Investment returns, reduced by operating distribution above	(124,724)	(146,810)	(3,795)	(275,329)	(31,016)
Revenues of consolidated endowment investments	23,557	-	-	23,557	18,203
Expenses of consolidated endowment investments	(35,480)	-	-	(35,480)	(24,274)
Net assets released from restrictions	42,625	(42,862)	237	-	-
Change in liabilities due under life-income agreements	-	(13,686)	1,507	(12,179)	(7,649)
Other nonoperating changes, net	1,441	-	-	1,441	(23,960)
Net nonoperating changes	(83,811)	(179,449)	18,959	(244,301)	6,797
Total (decrease) increase in net assets controlled by Rice University	(92,616)	(166,003)	18,959	(239,660)	33,694
Net loss attributable to noncontrolling interest	5,755	-	-	5,755	1,166
Total (decrease) increase in net assets - Rice	(86,861)	(166,003)	18,959	(233,905)	34,860
<b>Net assets - Rice</b>					
Beginning of year	2,970,553	2,286,996	1,100,703	6,358,252	6,323,392
End of year	2,883,692	2,120,993	1,119,662	6,124,347	6,358,252
<b>Net assets - Noncontrolling interest</b>					
Beginning of year	29,333	-	-	29,333	-
Net loss	(5,755)	-	-	(5,755)	(1,166)
Net of equity transactions	14,726	-	-	14,726	30,499
End of Year	38,304	-	-	38,304	29,333
<b>Total net assets</b>	<b>\$ 2,921,996</b>	<b>\$ 2,120,993</b>	<b>\$ 1,119,662</b>	<b>\$ 6,162,651</b>	<b>\$ 6,387,585</b>

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

**William Marsh Rice University**  
**Consolidated Statements of Cash Flows**  
**Years Ended June 30, 2016 and 2015**

(in thousands of dollars)

	2016	2015
<b>Cash flows from operating activities</b>		
Total (decrease) increase in net assets controlled by Rice	\$ (239,660)	\$ 33,694
Adjustments to reconcile increase (decrease) in net assets to net cash used in operating activities		
Depreciation of property and equipment	68,414	67,080
Loss on disposal of property and equipment	1,489	616
Net realized and unrealized investment (gains) loss	62,446	(163,024)
Contributions restricted for long term purposes and noncash contributions	(33,412)	(54,046)
Donated securities received	(14,479)	(25,292)
Proceeds from sale of donated securities	6,661	10,004
Actuarial change in life-income agreements	12,181	7,649
Change in fair value of commodity swap agreements	(615)	(405)
Gain on settlement of beneficial interest in escrow funds	(1,983)	-
Interest rate swap termination	-	(7,365)
Gain on settlement of interest rate swap agreements	-	(3,748)
Loss (gain) on extinguishment of debt	-	27,196
Debt prepayment costs	-	(28,128)
Change in		
Accounts receivable and other assets	23,465	(31,096)
Accounts receivable associated with consolidated endowment companies	(5,357)	(7,713)
Pledges receivable for current purposes	13,339	(27,267)
Liabilities of consolidated endowment investments	1,592	27,366
Accounts payable and other liabilities	7,183	1,461
Net cash used in operating activities	<u>(98,736)</u>	<u>(173,018)</u>
<b>Cash flows from investing activities</b>		
Proceeds from sales and maturities of investments	1,037,991	1,054,496
Purchases of investments	(829,110)	(939,491)
Purchases of investments by consolidated endowment companies	(28,339)	-
Purchases of consolidated endowment investments, net of cash acquired	-	(8,549)
Purchases of fixed assets by consolidated endowment investments	(87,266)	(16,700)
Purchases of property and equipment	(74,663)	(66,766)
Net cash (used in) provided by investing activities	<u>18,613</u>	<u>22,990</u>
<b>Cash flows from financing activities</b>		
Contributions restricted for endowment	4,397	18,702
Contributions restricted for property	7,983	16,049
Contributions restricted for trusts and other	15,511	16,441
Proceeds from sale of interest in consolidated investment company	16,783	-
Dividends paid by consolidated investment companies to non-controlling interest	(3,522)	-
Proceeds from sale of donated securities restricted for endowment	5,369	10,363
Proceeds from sale of donated securities restricted for property	2,449	4,925
Principal payment of tax-exempt bonds	(22,635)	(2,500)
Advance refunding of tax-exempt bonds	-	(537,315)
Proceeds from issuance of taxable commercial paper	-	22,365
Payment of outstanding tax-exempt commercial paper	(6,930)	(25,695)
Proceeds from issuance of taxable bonds	-	695,955
Issuance cost for taxable bonds	-	(662)
Issuance of debt from consolidated endowment investments	5,703	44,584
Increase in government refundable advances	111	89
Net cash provided by financing activities	<u>25,219</u>	<u>263,301</u>
Net (decrease) increase in cash and cash equivalents	<u>(54,904)</u>	<u>113,273</u>
<b>Cash and cash equivalents</b>		
Beginning of year	<u>125,820</u>	<u>12,547</u>
End of year	<u>\$ 70,916</u>	<u>\$ 125,820</u>

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

**William Marsh Rice University**  
**Consolidated Statements of Cash Flows**  
**Years Ended June 30, 2016 and 2015**

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**Noncash investing activities:** The University had open accounts payable and accruals of \$4,799 at June 30, 2016 and of \$3,201 at June 30, 2015, related to property, plant and equipment purchases.

**Donated Securities:** The consolidated statements of cash flows include \$14,479 and \$25,292 of donated securities for the years ended June 30, 2016 and 2015 respectively.

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



# William Marsh Rice University

## Notes to Consolidated Financial Statements

### June 30, 2016 and 2015

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*(all dollar amounts in thousands)*

#### 1. Basis of Presentation and Summary of Significant Accounting Policies

##### **Basis of Presentation**

William Marsh Rice University (the "University") is a Texas not-for-profit corporation that operates a private research university in Houston, Texas. The consolidated financial statements of the University as of June 30, 2016 and 2015, and for the years then ended, have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Accordingly, the accompanying consolidated financial statements have been prepared on the accrual basis of accounting and include the accounts of the University and all consolidated subsidiaries. All material transactions between the University and its subsidiaries have been eliminated.

The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the University's financial statements for the year ended June 30, 2015, from which the summarized information was derived.

The consolidated financial statements of the University include the accounts of all academic and administrative departments of the University, and affiliated organizations that are controlled by the University. The University is the controlling owner for several entities that are investments of the endowment and has presented the noncontrolling interests in the Consolidated Statements of Financial Position and the Consolidated Statements of Activities to reflect the results attributable to other owners. The revenues and expenses of the consolidated endowment investments are presented in the nonoperating section of the Consolidated Statements of Activities.

##### **Net Asset Categories**

Standards for external financial reporting by not-for-profit organizations require that resources be classified for reporting purposes into three net asset categories according to donor-imposed restrictions. A description of the University's three net asset categories follows:

- a. Unrestricted net assets and related activity include the following:
  1. All revenues traditionally classified as unrestricted resources of the University, including tuition and fees, unrestricted gifts, investment returns on unrestricted funds designated to function as endowment, recovery of facility and administrative costs from grants and contracts and auxiliary enterprise revenues;
  2. Revenues related to sponsored research and other sponsored program agreements, which are considered exchange transactions;
  3. Unrestricted funds functioning as endowment;
  4. Gifts with donor imposed restrictions, if the restriction was met within the current fiscal year of the University;
  5. Investments in plant assets; and
  6. All expenses of the University.

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**Notes to Consolidated Financial Statements**  
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*(all dollar amounts in thousands)*

- b. Temporarily restricted net assets include gifts for which donor-imposed restrictions have not been met and investment returns from unrestricted and restricted endowments. The restriction on unrestricted endowment returns (income and realized and unrealized gains and losses) is released when appropriations are distributed for use in the current fiscal year. The category also includes pledges receivable and life income gifts for which the ultimate purpose of the proceeds is not permanently restricted.
- c. Permanently restricted net assets include gifts, trusts and pledges on which donors have imposed the restriction that the corpus be maintained in perpetuity and only the investment returns be made available for program operations. In the case of trusts, gains and losses are added to the gift amount. Gifts restricted by donors to provide loans to students are also included in permanently restricted net assets.

The terms of certain gifts of real property made by the founder of the University provide that all returns realized from these properties are to be invested to generate income to be used for University purposes. Changes in the market value of these specific properties, whether gains or losses, are recorded as permanently restricted as required by the donor.

Expirations of temporary restrictions on net assets are reported as released from restrictions in the Consolidated Statements of Activities. Donor required matching from University funds and donor release or clarification of restrictions is also included in this line.

The Board of Trustees interprets the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), as adopted in Texas, to require the preservation of the original gift as of the gift date of the donor restricted endowment funds absent explicit donor stipulation to the contrary. As a result of this interpretation, the University classifies as permanently restricted net assets: (a) the original value of gifts donated to the permanent endowment; (b) the original value of subsequent gifts to the permanent endowment; and (c) other additions to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the addition is added to the fund. The remaining portion of the donor restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA (Note 5).

**Contributions**

Contributions, including unconditional promises to give and irrevocable trusts held by others under which the University is the beneficiary, are recognized as revenues in the period received or promised. Contributions restricted for the acquisition of land, buildings and equipment are reported as temporarily restricted revenues. These contributions are reclassified to unrestricted net assets when the assets are placed in service. Promises to give that are subject to donor-imposed stipulations that the corpus be maintained in perpetuity are recognized as increases in permanently restricted net assets.

It is the University's practice to sell marketable securities received as donations upon receipt. In the Consolidated Statements of Cash Flows, the University classifies cash receipts from the sale of donated marketable securities in a manner that is consistent with cash donations received if the donated marketable securities are converted into cash on receipt or shortly thereafter.

# William Marsh Rice University

## Notes to Consolidated Financial Statements

### June 30, 2016 and 2015

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*(all dollar amounts in thousands)*

Conditional promises to give are not recognized until the conditions on which they depend are met. Contributions of assets other than cash are reported at their estimated fair value at the date of gift. Contributions scheduled to be received after one year are discounted using a market rate (Note 3). Amortization of the discount is recorded as contribution revenue.

#### **Operating and Nonoperating Activities**

The Consolidated Statements of Activities report the change in net assets from the University's operating and nonoperating activities. Operating activities exclude: (a) gifts, grants and pledges for property and endowment (including annuity and life income trusts); (b) release from restrictions of contributions restricted for the acquisition of property and equipment; (c) donor release of restrictions from permanently restricted net assets; (d) endowment returns net of the University's operating needs as defined by University spending policy (Note 5); (e) actuarial adjustments of annuities payable; (f) changes in fair value of swap agreements (Note 6); (g) net gain or loss on nonrecurring transactions; and (h) activities of investment subsidiaries of the endowment which are consolidated for financial reporting purposes.

#### **Cash and Cash Equivalents**

The University considers all highly liquid financial instruments with an original maturity of 90 days or less to be cash equivalents, except those amounts assigned to its investment managers and unspent bond and commercial paper proceeds, which are classified as investments. Also included in the Consolidated Statements of Financial Position are the cash and cash equivalents of endowment investment companies consolidated with the University. These cash balances are shown in a separate line item as these funds are not available to the University but are for the use of the endowment investment company to whom these assets belong. The Consolidated Statements of Cash Flows has been prepared with both lines included.

#### **Investments and Other Financial Instruments**

Investments are made within guidelines authorized by the University's Board of Trustees. Investments are initially recorded at cost at date of acquisition or fair value at date of donation in the case of gifts. Ownership of marketable securities is recognized as of the trade date. Marketable securities transactions that have not settled are recognized as accounts receivable or accounts payable until the settlement date. Endowment income is calculated net of internal and external investment management expenses.

Investments are stated at fair value. Fair value is defined as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

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

**William Marsh Rice University**  
**Notes to Consolidated Financial Statements**  
**June 30, 2016 and 2015**

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*(all dollar amounts in thousands)*

The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by the University for financial instruments measured at fair value on a recurring basis (Note 6). The three levels of inputs are as follows:

- Level 1      Quoted prices in active markets for identical assets or liabilities, such as exchange-traded equity securities.
  
- Level 2      Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the same term of the assets or liabilities, including corporate bonds and most Treasury securities.
  
- Level 3      Unobservable inputs, such as valuations supplied by the investment managers, that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities, including investments in certain hedge strategies and all private market strategies.

In addition to these three valuation methodologies, as a practical expedient, the University is permitted under GAAP to estimate the fair value of its investments with external managers using the external managers' reported net asset value ("NAV") without further adjustment unless the University expects to sell the investment at a value other than NAV or the NAV is not calculated in accordance with GAAP.

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

The estimated fair value of certain alternative investments, such as private equity and other limited partnership interests, is based on valuations provided by the general partners or partnership valuation committees. These valuations consider variables such as financial performance of investments, recent sale prices of similar investments and other pertinent information. The University reviews and evaluates the data used in determining fair value, including the valuation methods, assumptions, and values provided by the investment managers. Because alternative investments are not readily marketable, their estimated fair value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed. These differences could be material.

Direct investments in natural resources, specifically timberland and oil and gas, as well as real estate are primarily valued using a combination of independent appraisals and/or one or more industry standard valuation techniques (e.g., income approach, market approach, or cost approach). The income approach is primarily based on the investment's anticipated future income using one of two principal methods: the discounted cash flow method or the capitalization method. Inputs and estimates developed and utilized in the income approach may be subjective and require judgment regarding significant matters such as estimating the amount and timing of future cash flows and the selection of discount and capitalization rates that appropriately reflect market and credit risks. The market approach derives investment value through comparison to recent and relevant market transactions with similar investment characteristics. The cost approach is utilized when the cost of the investment is determined to be the best representation of fair value. This method is typically used for newly purchased or undeveloped assets. The valuation process

# William Marsh Rice University

## Notes to Consolidated Financial Statements

### June 30, 2016 and 2015

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*(all dollar amounts in thousands)*

encompasses a wide range of procedures that in the aggregate allow the University to assert as to the adequacy of the fair values reported as of the measurement date.

Derivative financial instruments are recorded in the Consolidated Statements of Financial Position as either an asset or liability measured at fair value as of the reporting date. Derivative financial instruments consist of energy hedge agreements. Changes in fair value of these derivatives are recognized in the Consolidated Statements of Activities.

The University's investments are exposed to a number of risks including interest rate, market, and credit risks. Due to the level of risk exposure, it is possible that changes in the valuation of these investments may occur in the near term and that such changes could be material.

#### **Property and Equipment**

Property used by the University is stated at cost for purchased assets and fair value at the date of donation in the case of gifts. Interest expense incurred during the period of construction of an asset for University use is capitalized until that asset is substantially completed and ready for use. The University depreciates its physical assets (excluding works of art, which are not depreciated) using the straight-line method over their estimated useful lives. Repairs and maintenance of property and equipment are expensed as incurred. Property and equipment are removed from the records at the time of disposal. Any resulting gain or loss on disposal is recognized in the nonoperating portion of the Consolidated Statements of Activities.

Works of art, historical treasures, literary works and artifacts are preserved and protected for educational, research and public exhibition purposes. Donations and purchases of such collections are recorded for financial statement purposes as property and equipment.

#### **Asset Retirement Obligations**

The University recognizes asset retirement obligations ("AROs") that are conditional on a future event, such as the legal obligation to safely dispose of asbestos when a building is remodeled or demolished. The University measures conditional AROs at estimated fair value using a probability-weighted, discounted cash flow model with multiple scenarios, if applicable. The present value of weighted, discounted cash flows is calculated annually using credit-adjusted, risk-free rates applicable to the University in order to determine the estimated fair value of the conditional AROs.

#### **Life Income Agreements**

Life income agreements include charitable remainder trusts and gift annuities. Charitable remainder trusts hold donated assets for which the University's subsidiary acts as trustee and periodically pays specified amounts to the designated beneficiaries. Generally, beneficiary payments are a fixed amount for annuity trusts and a fixed percentage of the fair value of the trust assets or based on income earned for other charitable remainder trusts. At a date specified in each gift instrument, usually the beneficiary's date of death, ownership of the trust assets will transfer to the University and the beneficiary payments will cease. The University also enters into gift annuity agreements, which require that the University take ownership of the assets at the date of gift with an obligation to periodically pay specified amounts to designated beneficiaries for their lifetimes. Assets held in life income trusts and those assets associated with gift annuities are included in investments at fair value. Contribution revenues are recognized at the date the trusts or gift annuities are established at the net present value calculated based on an actuarial table. Liabilities are recorded at the same time using actuarial tables and discounted according to the risk-free rate at the time of the gift. Discount rates range from 1% to 6%. The liability represents

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## Notes to Consolidated Financial Statements

### June 30, 2016 and 2015

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*(all dollar amounts in thousands)*

the present value of the estimated future payments to be made to the beneficiaries. The liabilities are adjusted annually for changes in the value of the assets and actuarial changes, which impact the estimates of future payments.

#### **Grants and Contracts**

Revenues from both government and private sources are recognized as earned in accordance with the terms of the grant or contract. Any payment received prior to it being expended is recorded as a refundable advance. Projects that incur expenses prior to payment receipt are recorded as revenue with a corresponding receivable. The recovery of indirect costs, also referred to as facilities and administrative costs, is recognized primarily based on predetermined rates negotiated with the federal government (Note 12). The amount of indirect cost permitted to be recovered is determined on a per grant or contract basis.

#### **Use of Estimates**

Financial statements prepared in conformity with accounting principles generally accepted in the United States of America rely on estimates. Management makes certain estimates and assumptions which affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities, and reported revenues and expenses during the period. Actual results could differ from these estimates.

#### **Credit Risk**

The University maintains operating cash and other cash balances in financial institutions which from time to time may exceed federally insured limits. The University periodically assesses the financial condition of these institutions and believes that the risk of loss is minimal.

The University has evaluated the credit risk associated with financing receivables, primarily student loans, and determined that both the receivables and the related allowances are immaterial to the financial statements.

#### **Tax Status**

The University is exempt from federal income tax to the extent provided under Section 501(c)(3) of the Internal Revenue Code. The IRS issued a determination letter in January 1938 that recognized the University as exempt from federal income tax under Section 501(c)(3). The IRS confirmed in 2008 that this exemption still applies.

The University has 14 subsidiary corporations that are included in the consolidated financial statements. Six of these subsidiary corporations are exempt from federal income taxes under 501(c)(2), two are exempt under 501(c)(3), one is exempt under 501(c)(4), and five are subject to taxation. The University is classified as an organization that is not a private foundation under Section 509(a) of the Internal Revenue Code because it is described in Sections 509(a)(1) and 170(b)(1)(A)(ii) and, as such, gifts to the University qualify for deduction as charitable contributions to the extent provided by law. The University and its subsidiary corporations that are exempt from federal income tax are required to pay federal income tax on unrelated business income. The University and its subsidiary corporations recorded estimated income tax liabilities of \$150 and \$240 for the years ended June 30, 2016 and 2015, respectively. The University has no financial reporting requirements for uncertain tax positions for the years ended June 30, 2016 and 2015.

# William Marsh Rice University

## Notes to Consolidated Financial Statements

### June 30, 2016 and 2015

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*(all dollar amounts in thousands)*

#### **Recently Adopted Accounting Standards**

In July 2014, the University early adopted new guidance about Fair Value Measurement and Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent). This guidance requires the University to show investments that use NAV as a practical expedient for valuation purposes separately from other investments categorized in the fair value hierarchy described in Note 6. This disclosure change, which was applied retrospectively, can be seen in the investment leveling tables shown in Note 6.

In April 2015, the Financial Accounting Standards Board (“FASB”) issued an ASU relating to the presentation of debt issuance costs on the statement of financial position. This standard amends existing guidance to require the presentation of debt issuance costs on the statement of financial position as a deduction from the carrying amount of the related debt liability instead of as a deferred charge. This guidance is effective for fiscal years beginning after December 15, 2018. The University has elected to early adopt this guidance on a retrospective basis effective for the year ended June 30, 2016. In order to comply with this new standard, unamortized deferred financing costs previously classified on the consolidated statements of financial position as a deferred charge within the assets section have been reclassified as a direct reduction from the carrying amount of long-term debt within the liabilities section on the consolidated statements of financial position. The impact of adoption was a decrease of \$8,708 and \$8,825 in both assets and liabilities on the consolidated statements of financial position at June 30, 2016 and 2015, respectively.

In January 2016, the FASB issued an ASU related to the recognition and measurement of financial assets and financial liabilities. This standard affects all entities that hold financial assets or owe financial liabilities and primarily affects the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. The standard is effective for non-public business entities for annual periods beginning after December 15, 2018. The university early elected to early adopt this guidance eliminating the fair value disclosures for financial instruments not recognized at fair value at June 30, 2016.

#### **New Pronouncements**

In May 2014, the FASB issued a standard on Revenue from Contracts with Customers. This standard implements a single framework for recognition of all revenue earned from customers. This framework ensures that entities appropriately reflect the consideration to which they expect to be entitled in exchange for goods and services by allocating transaction price to identified performance obligations and recognizing revenue as performance obligations are satisfied. Qualitative and quantitative disclosures are required to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The standard is effective for fiscal years beginning after December 15, 2017. The University is evaluating the impact this will have on the consolidated financial statements beginning in fiscal year 2019.

In February 2016, the FASB issued new guidance related to leases in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The new guidance is effective for fiscal years beginning after December 15, 2018. The University is evaluating the impact this will have on the consolidated financial statements beginning in fiscal year 2020.

In August 2016, the FASB issued a standard on Presentation of Financial Statements of Not-for-Profit Entities. This standard requires a different presentation of net asset classifications as well as

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additional note disclosures about liquidity, financial performance and cash flows. The standard is effective for fiscal years beginning after December 15, 2017. The University is evaluating the impact this will have on the consolidated financial statements beginning in fiscal year 2019.

**Revision of Previously Issued Financial Statement**

The University has revised its 2015 Statement of Cash Flows to adjust its presentation of interest rate swap termination payments and the impact of noncontrolling interests. It also moved interest rate swap termination from the bond refinancing from the financing to the operating section of the cash flows. The effect of the revision was to increase cash used in operating activities by \$37,864, from (\$135,154) to (\$173,018), to increase cash provided by investing activities by \$30,499, from (\$7,509) to \$22,990, and to increase cash provided by financing activities by \$7,365, from \$255,936 to \$263,301. No other financial statements were impacted by the change. The University does not consider the changes to be material to the fiscal year 2015 financial statements taken as a whole.

**2. Accounts Receivable and Other Assets**

Accounts receivable and other assets of the University at June 30, 2016 and 2015, were as follows:

	<b>2016</b>	<b>2015</b>
Unsettled investment sales and receivables	\$ 17,495	\$ 12,434
Investment income receivable	3,194	3,266
Student loans receivable, net of allowance of \$879 in 2016 and \$1,097 in 2015	11,465	11,202
Inventory, prepaid expenses, and other assets	9,164	9,510
Sponsored programs receivable	20,686	21,184
Beneficial interest in escrow funds related to settlement of debt	-	23,000
Swap agreements	483	-
Other accounts receivable, net of allowance of \$1,469 in 2016 and \$479 in 2015	<u>7,215</u>	<u>7,105</u>
University accounts receivable and other assets	69,702	87,701
Accounts receivable and other assets of consolidated endowment investments	<u>11,903</u>	<u>6,545</u>
Total accounts receivable and other assets	<u>\$ 81,605</u>	<u>\$ 94,246</u>



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**3. Pledges Receivable**

Unconditional promises to give are included in the consolidated financial statements as pledges receivable and revenue of the appropriate net asset category. Multi-year pledges are recorded after discounting to the present value of expected future cash flows. Unconditional promises to give at June 30, 2016 and 2015 are expected to be realized in the following periods:

	<b>2016</b>	<b>2015</b>
In one year or less	\$ 59,758	\$ 25,454
Between one year and five years	83,793	152,753
More than five years	<u>65,898</u>	<u>43,263</u>
Gross pledges receivable	209,449	221,470
Less:		
Discount to net present value	(21,144)	(24,118)
Allowance for uncollectible pledges	<u>(12,567)</u>	<u>(13,289)</u>
Net pledges receivable	<u>\$ 175,738</u>	<u>\$ 184,063</u>

Pledges receivable at June 30, 2016 and 2015, had the following restrictions:

	<b>2016</b>	<b>2015</b>
Long-term investment	\$ 44,126	\$ 37,302
Buildings	67,855	80,722
Support of University programs and activities	<u>97,468</u>	<u>103,446</u>
Gross pledges receivable	209,449	221,470
Less:		
Discount to net present value	(21,144)	(24,118)
Allowance for uncollectible pledges	<u>(12,567)</u>	<u>(13,289)</u>
Net pledges receivable	<u>\$ 175,738</u>	<u>\$ 184,063</u>

Rates ranging from 1% to 6% are used to discount pledges. A reserve rate of 6% was used for the allowance for uncollectible pledges as of June 30, 2016 and 2015. The reserve rate is reviewed annually to ensure adequate provision for uncollectible amounts.

At June 30, 2016 and 2015, the University had conditional pledge commitments of \$54,250 and \$55,900, respectively, from two donors for the construction of a campus building and a program initiative. These are not reported in the consolidated financial statements.

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**4. Investments**

Investments at June 30, 2016 and 2015, were as follows:

	<b>2016</b>	<b>2015</b>
Short term investments and fixed income securities	\$ 886,922	\$ 1,025,714
Equity securities and equity funds	1,803,005	1,907,714
Limited partnerships and other funds	2,500,159	2,545,557
Real assets, oil and gas, and other	<u>587,355</u>	<u>553,628</u>
University investments	<u>\$ 5,777,441</u>	<u>\$ 6,032,613</u>

Investments include annuity and life income fund assets of \$159,515 and \$164,475 as of June 30, 2016 and 2015, respectively. Fixed income securities include unspent bond proceeds that are available to fund project expenditures in future years (Note 10).

The following table presents investment income and net gains (losses) for the year ended June 30, 2016 by net asset classification, with summarized information for the year ended June 30, 2015:

	<b>2016</b>			<b>Total</b>	<b>2015</b>
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>		<b>Total</b>
Investment earnings	\$ 24,304	\$ 23,730	\$ 5,516	\$ 53,550	\$ 56,410
Net (losses) gains on investments	<u>(22,476)</u>	<u>(30,659)</u>	<u>(9,311)</u>	<u>(62,446)</u>	<u>163,024</u>
Total investment (losses) gains and earnings	1,828	(6,929)	(3,795)	(8,896)	219,434
Investment earnings for unrestricted purposes	24,775	(24,775)	-	-	-
Less: Investment returns distributed for operations	<u>(151,327)</u>	<u>(115,106)</u>	-	<u>(266,433)</u>	<u>(249,284)</u>
Net investment returns, reduced by operating distribution	<u>\$ (124,724)</u>	<u>\$ (146,810)</u>	<u>\$ (3,795)</u>	<u>\$ (275,329)</u>	<u>\$ (29,850)</u>

Return on investments is presented net of investment management fees. Certain expenses paid directly by the University for investment management and custody services, including certain internal costs, amounted to approximately \$49,500 and \$46,500 for the years ended June 30, 2016 and 2015, respectively. Certain investments report net returns without specific identification of management fees.

**5. Endowments**

The University's endowment pool consists of approximately 1,700 individual donor restricted endowment funds and approximately 200 funds designated by the Board of Trustees to function as endowment funds. The net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor imposed restrictions.

The following table presents endowment net asset composition by type of fund for the year ended June 30, 2016, with summarized information for the year ended June 30, 2015.

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	2016			Total	2015
	Unrestricted	Temporarily Restricted	Permanently Restricted		Total
Donor restricted	\$ -	\$ 1,921,451	\$ 1,103,311	\$ 3,024,762	\$ 3,142,104
Board designated	2,329,746	-	-	2,329,746	2,430,934
Total endowment funds	2,329,746	1,921,451	1,103,311	5,354,508	5,573,038
Pledges restricted for long-term investment, net of discount and allowance	-	-	(37,609)	(37,609)	(32,594)
Endowment funds excluding pledges	\$ 2,329,746	\$ 1,921,451	\$ 1,065,702	\$ 5,316,899	\$ 5,540,444

In accordance with UPMIFA, the University considers the following factors in making a determination to appropriate or accumulate endowment funds:

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

**Endowment Investment Policies**

The University has adopted endowment investment policies that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain, and, if possible, enhance the purchasing power of endowment assets. The University has a diversified approach to management of the endowment investment portfolio. By diversifying among asset classes and rebalancing toward policy target allocations, the University strives to manage and maintain the risk profile implied by the policy targets adopted by the Board of Trustees.

To achieve its long term return objectives, the University relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). The University's diversified asset allocation places greater emphasis on equity based investments to achieve its long-term objectives within prudent risk and liquidity constraints. The long term investment objectives of the endowment are to attain an average annual real total return in excess of endowment spending and to outperform various strategic policy and comparable industry universe benchmarks over the long term.

**Endowment Spending Allocation and Relationship of Spending Policy to Investment Objectives**

The Board of Trustees of the University approves the appropriation of endowment funds for expenditure. In establishing a distribution policy, the Board of Trustees considered a number of factors, including the expected long term investment rate of return on the endowment. Accordingly,

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over the long term, the University expects the current spending policy to allow its endowment assets to grow, consistent with its intention to maintain the purchasing power of the endowment assets while providing a relatively predictable and stable (in real terms) stream of earnings for current use. Under the University's endowment earnings distribution policy, endowment returns on donor restricted endowments, net of operating distributions, remain in the investment pool as temporarily restricted net assets and endowment returns on board designated endowment funds, net of operating distributions, remain in the investment pool as unrestricted net assets functioning as endowment.

**Endowment Funds With Deficits**

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts creating a deficit. These deficits generally result when unfavorable market fluctuations occur shortly after the investment of newly established endowments. Deficits in donor restricted endowment funds are classified as a reduction of unrestricted net assets in the year they occur and as an increase in unrestricted net assets in the year the fair value exceeds the gift amounts. There were no material deficits of this nature as of June 30, 2016 and 2015.

Changes in endowment net assets for the year ended June 30, 2016, with summarized information for the year ended June 30, 2015, were as follows:

	2016			2015	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
<b>Endowment net assets at beginning of year</b>	\$ 2,430,934	\$ 2,059,021	\$ 1,083,083	\$ 5,573,038	\$ 5,553,717
Investment returns					
Investment income	42,364	24,677	6,490	73,531	60,085
Net realized and unrealized (losses) gains	(22,476)	(29,674)	(7,018)	(59,168)	166,404
Total investment returns	19,888	(4,997)	(528)	14,363	226,489
Contributions	-	-	20,046	20,046	19,545
Appropriation of endowment assets for expenditure	(126,702)	(139,792)	-	(266,494)	(247,671)
Other changes					
Transfers to board designated endowment funds	5,358	-	-	5,358	12,336
Donor designation	-	-	710	710	8,027
Other transfers	268	7,219	-	7,487	595
Change in endowment net assets	(101,188)	(137,570)	20,228	(218,530)	19,321
<b>Endowment net assets at end of year</b>	\$ 2,329,746	\$ 1,921,451	\$ 1,103,311	\$ 5,354,508	\$ 5,573,038

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**6. Financial Instruments**

The following tables present the financial instruments carried at fair value on the Consolidated Statements of Financial Position as of June 30, 2016 and 2015, by category, in accordance with the valuation hierarchy defined in Note 1. Certain alternative investments, such as hedge funds, that do not have readily determinable fair values, are shown at investee-reported net asset value per share:

	2016				
	Level 1	Level 2	Level 3	NAV	Total
<b>Investments</b>					
Short term investments and fixed income securities					
Cash and equivalents	\$ 109,483	\$ -	\$ -	\$ -	\$ 109,483
Short term investments	-	480,450	-	-	480,450
Investment grade U.S. bonds	-	282,790	-	-	282,790
Equity securities	726,128	-	-	-	726,128
Equity funds	-	-	-	945,731	945,731
Limited partnerships and other funds					
Private equity and venture capital	-	-	-	877,049	877,049
Hedge	-	-	-	1,159,452	1,159,452
Real estate	-	-	-	198,441	198,441
Energy and natural resources	-	-	-	265,217	265,217
Real assets, oil and gas, and other	65,417	-	507,768	-	573,185
Life income agreements	158,586	822	107	-	159,515
Total investments at fair value	<u>\$ 1,059,614</u>	<u>\$ 764,062</u>	<u>\$ 507,875</u>	<u>\$ 3,445,890</u>	<u>\$ 5,777,441</u>
Swaps receivable	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 483</u>	<u>\$ -</u>	<u>\$ 483</u>

	2015				
	Level 1	Level 2	Level 3	NAV	Total
<b>Investments</b>					
Short term investments and fixed income securities					
Cash and equivalents	\$ 108,648	\$ -	\$ -	\$ -	\$ 108,648
Short term investments	-	669,107	-	-	669,107
Investment grade U.S. bonds	-	267,190	-	-	267,190
Equity securities	740,071	-	-	-	740,071
Equity funds	-	-	-	998,080	998,080
Limited partnerships and other funds					
Private equity and venture capital	-	-	-	995,115	995,115
Hedge	-	-	-	1,180,134	1,180,134
Real estate	-	-	-	187,162	187,162
Energy and natural resources	-	-	-	183,596	183,596
Real assets, oil and gas, and other	40,490	-	498,545	-	539,035
Life income agreements	163,458	910	107	-	164,475
Total investments at fair value	<u>\$ 1,052,667</u>	<u>\$ 937,207</u>	<u>\$ 498,652</u>	<u>\$ 3,544,087</u>	<u>\$ 6,032,613</u>
Swaps payable	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (132)</u>	<u>\$ -</u>	<u>\$ (132)</u>

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The following tables present the changes in amounts included in the Consolidated Statements of Financial Position for financial instruments classified by the University within Level 3:

**Investments**

	Real Assets, Oil and Gas, and Other	Life Income Agreements	Total
<b>Fair value June 30, 2015</b>	\$ 498,545	\$ 107	\$ 498,652
Realized gains	19,211	-	19,211
Unrealized losses	(19,358)	-	(19,358)
Capital calls/purchases	25,302	-	25,302
Distributions	(13,874)	-	(13,874)
Other	(2,058)	-	(2,058)
<b>Fair value June 30, 2016</b>	<u>\$ 507,768</u>	<u>\$ 107</u>	<u>\$ 507,875</u>

	Real Assets, Oil and Gas, and Other	Life Income Agreements	Total
<b>Fair value July 1, 2014</b>	\$ 498,798	\$ 868	\$ 499,666
Realized gains	7,438	-	7,438
Unrealized losses	(36,818)	(761)	(37,579)
Capital calls/purchases	76,170	-	76,170
Distributions	(7,336)	-	(7,336)
Other	539	-	539
Transfers out	(40,246)	-	(40,246)
<b>Fair value June 30, 2015</b>	<u>\$ 498,545</u>	<u>\$ 107</u>	<u>\$ 498,652</u>

**Swap Agreements**

	Commodity Swaps
<b>Fair value Asset/(Liability) July 1, 2015</b>	\$ (132)
Unrealized gains	615
<b>Fair value Asset/(Liability) June 30, 2016</b>	<u>\$ 483</u>

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	Interest Rate Swaps	Commodity Swaps	Total
<b>Fair value Asset/(Liability) July 1, 2014</b>	\$ (11,113)	\$ (537)	\$ (11,650)
Realized gains	3,748	-	3,748
Unrealized gains	-	405	405
Settlement of swap	7,365	-	7,365
<b>Fair value Asset/(Liability) June 30, 2015</b>	<u>\$ -</u>	<u>\$ (132)</u>	<u>\$ (132)</u>

The following table presents a summary of Level 3 valuation techniques and quantitative information utilized in determining the value of real assets, oil and gas, and other investments, where no practical expedient to using the external managers' reported NAV exists.

Asset Type	Fair Value		Valuation Technique	Unobservable Input	2016 Rates	2015 Rates
	2016	2015				
Real estate	\$ 265,978	\$ 252,535	Discounted cash flow	Discount rate	5.5%-8.5%	5.5%-8.5%
Timber	82,000	83,943	Income approach	Discount rate	5%-7%	6%-8%
Oil and gas	102,000	128,000	Discounted cash flow	Discount rate	8%-25%	8%-10%
Directly held private stock	57,188	33,491	Varies	Varies	Varies	Varies
Other	602	576	Varies	Varies	Varies	Varies
	<u>\$ 507,768</u>	<u>\$ 498,545</u>				

The University recognizes transfers between levels as of the end of the reporting period. There were no transfers between Level 1 and Level 2 in 2016 and 2015. There were no transfers between Level 2 and Level 3 in 2016 or 2015. There were transfers between Level 1 and Level 3 in 2015.

As a practical expedient, the University is permitted under GAAP to estimate the fair value of its investments with external managers using the external managers' reported NAV without further adjustment unless the University expects to sell the investment at a value other than NAV or the NAV is not calculated in accordance with GAAP. Investments valued at NAV primarily consist of the University's ownership in alternative investments (including limited partnerships and interests in certain hedge and other similar funds). For those investments not valued at NAV, the University utilizes a hierarchy of inputs in determining fair value (Note 1). The following is a description of the University's valuation methodologies for assets and liabilities measured at fair value. The methods described below may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the University believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

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

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

Fair value for Level 3 is based on valuation techniques that use significant inputs that are unobservable as they trade infrequently or not at all. The fair values held by funds that do not have readily determinable fair values are determined by the respective managers and are based on appraisals or other estimates that require varying degrees of judgment. If no public market exists for the investments, the fair value is determined by the manager taking into consideration, among other things, the cost of the investments, prices of recent significant placements of investments of the same issuer, and subsequent developments concerning the companies to which the investments relate. The University has performed due diligence with respect to these investments to ensure NAV or partners' capital per share is an appropriate measure of fair value as of June 30.

Hedge funds held by the University may be subject to restrictions that limit (i) the University's ability to redeem/withdraw capital from such funds during a specified period of time subsequent to the University's investment of capital (lockups) and/or (ii) the amount of capital that investors may redeem/withdraw as of given redemption/withdrawal dates (side pockets). Capital available for redemption/withdrawal may also be subject to redemption/withdrawal charges and may or may not include capital attributable to the University's participation in illiquid investments. These funds generally limit redemptions to monthly, quarterly, semiannually, annually or longer, at NAV, and require between 30 and 90 days prior written notice, limiting the University's ability to respond quickly to changes in market conditions. The value of hedge funds classified as NAV included investment lockups that will expire over the next 12 to 36 months of \$306,754 and \$571,543 at June 30, 2016 and 2015, respectively, and side pockets of \$50,412 and \$48,612 at June 30, 2016 and 2015, respectively, that had indeterminate redemption periods. The University's nonhedge fund investments restrict the ability to withdraw, which limits the University's ability to respond quickly to changes in market conditions. These investments are therefore illiquid.

The University entered into an agreement in June 2012 to hedge a portion of the cost of electricity that took effect on July 1, 2013. The estimated fair value of the arrangement was an asset of \$483 as of June 30, 2016 and a liability of \$132 as of June 30, 2015. The change in value is reported as other nonoperating change on the Consolidated Statements of Activities. The fair value of the agreements is the estimated amount that the University would pay or receive to terminate these contracts as of June 30.

Life income agreement assets consist primarily of mutual funds, with some directly held assets in real estate, oil and gas, and bonds. Life income investments included in Level 1 are cash and cash equivalents and mutual funds investing in equities, real estate funds and fixed income securities. Life income investments included in Level 2 are directly held bonds and U.S. Treasury securities. Life income investments included in Level 3 are directly held interests in real estate, oil and gas, and other investments. The life income agreement investments are managed by an external manager.



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**7. Property and Equipment**

Property and equipment at June 30, 2016 and 2015 were as follows:

	Estimated Useful Lives (Years)	2016	2015
Land	-	\$ 23,803	\$ 23,803
Buildings and improvements	20–50	1,474,699	1,459,584
Equipment, furniture and library books	2–20	424,932	406,230
Art	-	11,055	10,784
Construction in progress	-	63,181	24,676
Less: Accumulated depreciation	-	<u>(817,196)</u>	<u>(751,468)</u>
Property and equipment of educational plant		1,180,474	1,173,609
Fixed assets of consolidated endowment investments, net		<u>103,976</u>	<u>16,710</u>
Total property, plant, and equipment		<u>\$ 1,284,450</u>	<u>\$ 1,190,319</u>

**8. Accounts Payable and Other Liabilities**

Accounts payable and other liabilities at June 30, 2016 and 2015, were as follows:

	2016	2015
Unsettled investment purchases and advances	\$ 5,698	\$ 1,275
Vendor accounts payable	20,463	17,313
Accrued payroll and employee benefits	13,951	12,245
Sponsored programs unearned income	33,097	29,806
Other unearned income	6,700	5,140
Asset retirement obligations	5,348	5,153
Swap agreements	-	132
Accrued interest payable	4,408	6,039
Other liabilities	<u>3,904</u>	<u>3,394</u>
Total accounts payable and other liabilities	<u>\$ 93,569</u>	<u>\$ 80,497</u>

**9. Liabilities of Consolidated Endowment Investments**

Liabilities of consolidated endowment investments are the liabilities of the companies that the University endowment has invested in and are required to be consolidated in the University's financial statements. Unearned income is the future obligation for payments received for multi-year contracts. Notes payable are the debt obligations, secured by assets, of the borrower. The liabilities are the obligation of the underlying endowment investment companies with no recourse to the University.

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	2016	2015
Accrued interest payable	\$ -	\$ 167
Unearned income	24,981	25,960
Accrued payroll and employee benefits	1,041	-
Other accrued liabilities	3,211	-
Vendor accounts payable	3,555	4,992
Notes and bonds payable	<u>48,400</u>	<u>42,774</u>
Total liabilities of consolidated endowment investments	<u>\$ 81,188</u>	<u>\$ 73,893</u>

**10. Notes and Bonds Payable**

Notes and bonds payable at June 30, 2016 and 2015, were as follows:

	2016	2015
Taxable bonds, Series 2015, maturing 2016, 2045 and 2055, with an average coupon of 3.686% per annum payable semiannually	\$ 680,000	\$ 700,000
Taxable bonds, Series 2013, maturing 2061 through 2063, with an average coupon of 4.63% per annum payable semiannually	113,985	113,985
<b>City of Houston Higher Education Finance Corporation (CHHEFC)</b>		
Tax-exempt revenue bonds, Series 2010A & 2010B, maturing 2031 through 2048, with an average coupon of 5% per annum payable semiannually for Series 2010A and an average coupon of 0.43% per annum payable monthly for Series 2010B	121,250	121,250
Tax-exempt revenue bonds, Series 2007A & 2007B, maturing 2010 through 2047, with an average coupon of 4.75% per annum payable semiannually in 2014 and maturing 2016 through 2017 with an average coupon of 5% in 2015	<u>2,770</u>	<u>5,405</u>
Total bond liability	918,005	940,640
Taxable commercial paper notes, Series A, with interest ranging from 0.14% to 0.58% at June 30, 2016 per annum payable upon maturity	15,435	22,365
Net of deferred financing costs, premiums and discounts on bond issuances	<u>(2,379)</u>	<u>(2,302)</u>
Total notes and bonds payable	<u>\$ 931,061</u>	<u>\$ 960,703</u>

The University incurred interest expense and bond costs, net of interest earned, of approximately \$34,895 and \$33,505 in 2016 and 2015, respectively. Of these amounts, interest expense of \$34,895 and \$32,931 was charged to operations in 2016 and 2015, respectively. Interest expense of \$0 and \$574 was capitalized in 2016 and 2015, respectively. The University made interest payments of approximately \$37,038 and \$24,294 in 2016 and 2015, respectively.

# William Marsh Rice University

## Notes to Consolidated Financial Statements

### June 30, 2016 and 2015

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*(all dollar amounts in thousands)*

#### **Taxable Bonds**

##### **Series 2015**

On April 22, 2015, the University issued taxable bonds with a par value of \$700,000 with an underwriters discount of \$4,045 and issuance costs of \$662. Both will be amortized over the term of the bond issue. Interest payments on the bonds are payable semiannually. In May, 2016 \$20,000 matured and was repaid. The remaining bonds mature in the amount of \$340,000 on May 15, 2045 and \$340,000 due on May 15, 2055. Mandatory sinking fund redemption payments are required in each of four years leading up to the maturity dates.

Proceeds from these bonds were used to advance refund the Series 2013A and 2013B debt of \$247,180 and a portion of Series 2007A and 2007B revenue bonds of \$292,635 by irrevocably placing assets with a trustee to pay principal, interest and call premium on the obligations, terminate interest rate swap agreements and provide the University with \$92,930 proceeds to be used for future capital projects. The University recognized a loss on the extinguishment of debt of \$27,197 in 2015, which includes the write-offs discussed below and a gain on the termination of the interest rate swap agreements. Both of these items are included in the other nonoperating changes, net in the Consolidated Statements of Activities.

Legal provisions related to the advance refunding of the Series 2013A and 2013B tax-exempt revenue bonds, which were floating rate notes, required that funds sufficient to pay interest at the maximum rate permitted under the bond documents be placed in escrow. At June 30, 2015, the University had a beneficial interest in the escrow funds, the value of which would vary based on variable interest rates between June 30, 2015 and the date of the debt retirement. The University recorded an estimate of this asset of \$23,000 within accounts receivable and other assets at June 30, 2015. At May 15, 2016 the debt was retired and the university received the excess escrow funds shortly thereafter. The actual amount received was \$24,983 and is reflected in unspent bond proceeds. The gain of \$1,983 recorded as a result of the final refund has been included in the other nonoperating changes, net in the Consolidated Statements of Activities.

Unspent bond proceeds of \$97,939 and \$92,930 at June 30, 2016 and 2015, respectively were invested in a mutual fund holding U.S. government securities.

##### **Series 2013**

On June 26, 2013, the University issued taxable bonds. Interest payments on the bonds are payable semiannually beginning November 15, 2013. Principal payments start May 15, 2061 and continue annually until their maturity on May 15, 2063.

The proceeds of the bonds were used to refund all of the Series 2008A revenue bonds of \$100,000, refund a portion of the outstanding commercial paper notes of \$13,000, and pay the costs of issuance of the bonds of \$985.

#### **Tax-Exempt Revenue Bonds**

##### **Series 2010A and 2010B**

On June 2, 2010, the University issued Series 2010A and 2010B revenue bonds through the CHHEFC. The Series 2010A revenue bonds, with a face value of \$94,485, were issued as fixed rate debt with an average coupon of 5%. The Series 2010B revenue bonds, with a face value of \$39,765, were issued as variable rate demand bonds ("VRDBs"), which are subject to optional and mandatory tender. The University is not required to obtain or maintain a liquidity facility for the Series 2010B bonds.

**William Marsh Rice University**  
**Notes to Consolidated Financial Statements**  
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*(all dollar amounts in thousands)*

In the event that the University receives notice of any optional tender on its Series 2010B bonds, or if these bonds become subject to mandatory tender, the purchase price of the bonds will be paid from the remarketing of such bonds. However, if the remarketing proceeds are insufficient, the University is obligated to purchase the bonds tendered at 100% of par value on the tender date.

The Series 2010A bonds were issued with a \$5,637 original issue premium and issuance costs of \$606. The Series 2010B bonds were issued without an original issue premium or discount and are being amortized over the term of the bond issue. Interest payments on the Series 2010A bonds are payable semiannually and interest payments on the Series 2010B bonds are payable monthly. Principal payments for Series 2010A commence on May 15, 2031 and will be required annually until the scheduled maturity date of May 15, 2040. Principal payments for Series 2010B begin May 15, 2041 and continue annually until their maturity date on May 15, 2048. On June 20, 2013, the University returned \$13,000 of unspent Series 2010B bond proceeds.

Unspent bond proceeds of \$11,329 and \$15,697 at June 30, 2016 and 2015, respectively, were invested in a mutual fund holding U.S. government securities.

**Series 2007A and 2007B**

On June 12, 2007, the University issued Series 2007A and 2007B revenue bonds through the CHHEFC; Series 2007A bonds with a face value of \$209,165 and Series 2007B bonds with a face value of \$100,000. Interest payments on the bonds are payable semiannually.

On April 22, 2015, substantially all of the bonds were refunded in the amount of \$292,635 with proceeds of the Series 2015 taxable bonds. At June 30, 2016, there was \$2,770 outstanding which is scheduled to be paid by June 30, 2017 through regularly scheduled debt service payments.

The Series 2007A bonds were issued with a \$5,832 original issue premium and the Series 2007B bonds were issued net of a \$365 original issue discount. The underwriters discount and issuance costs of both issuances of \$2,538 were capitalized by the University and all are being amortized over the term of the bond issue. Remaining unamortized issuance premium, discounts and costs of \$2,088 were recognized as a loss at the time of refunding.

Principal maturities for notes and bonds payable as of June 30, 2016, excluding commercial paper and unamortized discounts and premiums, were as follows:

2017	\$ 2,770
2018	-
2019	-
2020	-
Thereafter	<u>915,235</u>
	<u>\$ 918,005</u>

**William Marsh Rice University**  
**Notes to Consolidated Financial Statements**  
**June 30, 2016 and 2015**

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*(all dollar amounts in thousands)*

**Commercial Paper Notes**

The University has a tax-exempt commercial paper program that provides for borrowings in the form of individual notes up to an aggregate of \$100,000. The notes bear a fixed rate of interest, established on the borrowing date, over their individual terms, not to exceed 270 days. The outstanding balance under the facility was \$0 at both June 30, 2016 and 2015.

The University established a taxable commercial paper program in May 2015 that provides for borrowings in the form of individual notes up to an aggregate of \$100,000. The notes bear a fixed rate of interest, established on the borrowing date, over their individual terms, not to exceed 270 days. The outstanding balance under the facility was \$15,435 and \$22,365 with an average interest rate of 0.55% and 0.16% and an average maturity of 33 days at June 30, 2016 and 2015.

**11. Student Financial Aid**

Gross student tuition and fees of \$261,186 and \$250,475 in 2016 and 2015, respectively, are presented in the consolidated financial statements net of scholarship and fellowship awards of \$98,237 and \$102,248, respectively. Auxiliary enterprises revenue was reduced by scholarship awards applied to room and board charges of \$6,394 and \$6,429 in 2016 and 2015, respectively. Scholarship and fellowship awards in excess of the above amounts are reported as expense.

**12. Grants and Contracts**

The major components of grants and contracts revenue for the years ended June 30, 2016 and 2015 were as follows:

	<b>2016</b>	<b>2015</b>
<b>Government</b>		
Direct	\$ 76,552	\$ 69,989
Indirect	<u>20,701</u>	<u>18,454</u>
Total government	<u>97,253</u>	<u>88,443</u>
<b>Foundation, industrial, and other</b>		
Direct	33,578	34,437
Indirect	<u>4,346</u>	<u>4,196</u>
Total foundation, industrial, and other	<u>37,924</u>	<u>38,633</u>
Total grants and contracts	<u>\$ 135,177</u>	<u>\$ 127,076</u>

The University receives funding from federal government agencies for research and other programs conducted under government grants and contracts. The grants and contracts provide for reimbursement of direct and indirect costs. The recovery of indirect costs, also referred to as facilities and administrative costs, is recognized based on predetermined rates negotiated with the federal government which are predetermined through fiscal year 2019.

**William Marsh Rice University**  
**Notes to Consolidated Financial Statements**  
**June 30, 2016 and 2015**

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*(all dollar amounts in thousands)*

**13. Functional Expenses**

Expenses of the University by major functional category for the years ended June 30, 2016 and 2015 were as follows:

	<b>2016</b>	<b>2015</b>
Instruction and department research	\$ 306,258	\$ 288,857
Sponsored research and other sponsored programs	117,351	101,544
Library	33,138	33,531
Scholarships and fellowships	20,003	19,077
Auxiliary enterprises	56,841	55,713
Student services	69,975	70,605
General administration	34,040	31,804
Institutional development and other activities	24,543	25,337
	<u>662,149</u>	<u>626,468</u>
Total operating expenses	<u>\$ 662,149</u>	<u>\$ 626,468</u>

The above table includes depreciation expense of \$58,005 and \$56,987 and operations and maintenance expense of \$45,795 and \$44,121 in 2016 and 2015, respectively, which were allocated to the major functional categories based on space usage. Depreciation of library books of \$10,409 and \$10,093 was recognized as library expense in 2016 and 2015, respectively. Interest of \$34,895 and \$32,931 in 2016 and 2015, respectively, was recorded by functional category based on identification of related construction projects.

**14. Related Party Transactions**

Members of the University's Board of Trustees and senior management may, from time to time, be associated, either directly or through interlocking board memberships, with entities doing business with the University. The University employs a conflict of interest policy that requires any such associations to be disclosed in writing on an annual basis and updated as appropriate during the year. When such associations exist, measures are taken to mitigate any actual or perceived conflict, including recusal of the board member from any decisions involving the entity doing business with the University. The transactions with entities associated with trustees or senior management are not considered to be significant and may include investment management, common membership in investment partnerships or other investment vehicles, or the purchase of goods or services.

**15. Retirement Plans**

Substantially all employees are eligible to participate in a defined contribution retirement plan, which is administered by a third party. The plan operates in accordance with Section 401(a) of the Internal Revenue Code. University contributions are made to this plan. In addition, employees may elect to participate in plans created under Section 403(b) of the Internal Revenue Code. The contributions of the University and its employees can be applied to a range of investments. The University's contributions to the plan of \$23,586 and \$22,633 were recorded as expense in the appropriate functional categories in 2016 and 2015, respectively.

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**Notes to Consolidated Financial Statements**  
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*(all dollar amounts in thousands)*

**16. Commitments and Contingencies**

A number of suits and claims are pending against the University. While final outcomes cannot be determined at this time, management believes, after consultation with its legal counsel, that the uninsured liability, if any, resulting from these suits and claims will not have a material adverse effect on the University's financial position, operations, or cash flows.

The University receives funding from federal government agencies for research and other programs conducted under government grants and contracts. The costs recovered by the University in support of sponsored programs are subject to audit and adjustment.

In connection with its private equity investment program (Note 4), the University is obligated under certain limited partnership agreements to advance additional funding up to levels specified in each agreement upon the request of the general partner. At June 30, 2016 and 2015, the University had unfunded commitments of approximately \$723,000 and \$670,000, respectively, which are expected to be called primarily over the next five to seven years.

Additionally, the University was committed under contracts at June 30, 2016 and 2015 for capital construction and improvements and major maintenance of approximately \$59,853 and \$37,061, respectively, to be financed primarily from gifts and net assets designated for long-term investments, and from debt to the extent other resources are not available. Other purchasing commitments of approximately \$8,420 and \$7,210 were also outstanding at June 30, 2016 and 2015, respectively.

**17. Subsequent Events**

The University evaluated subsequent events from July 1, 2016 to October 21, 2016, the date these consolidated financial statements were issued, for events that occurred after the financial position date that would have a material impact on the University's consolidated financial statements. No material items were noted which require disclosure.