Northwestern University
2013 FINANCIAL REPORT

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Report of the Senior Vice President for Business and Finance

To the Board of Trustees of Northwestern University:

With nationally ranked academic programs, Northwestern University attracts a highly qualified and diverse student body. The *2013 Financial Report* reflects the University's success in carrying out its mission of providing the highest-quality education for these students, developing innovative programs in research, and sustaining an academic community that embraces these enterprises.

Solid research funding, gifts, and endowment earnings—in addition to tuition—continue to provide balanced sources of revenues. A robust year in the investment markets is reflected in the statement of financial position. The investment vehicle for the University's endowment, the Long-Term Balanced Pool, had a net total return of 11.6 percent, contributing to the 9.7 percent increase in investments. Significant progress was made on the capital plan with the Southeast Campus Development Project construction, which increased the investment in land, buildings, and equipment. Total assets grew to $10.9 billion, an increase of more than $1 billion from the previous year. Total liabilities remained stable, while net assets increased to nearly $9.2 billion.

The University accelerated expected income from the drug Lyrica® by monetizing most of its remaining royalty interest and realized $290 million in additional royalty revenue. This one-time revenue was the primary factor in operating revenue increasing 21 percent over the prior year, to a total of $2.3 billion. Operating expenses increased 6 percent, to $1.9 billion. The resulting excess of operating revenue over expenses was $407 million, compared with $117 million in 2012. As before, the Lyrica proceeds were invested in the Long-Term Balanced Pool as quasi-endowments to primarily support financial aid, startup needs for new faculty, research initiatives, and construction.

While Northwestern is not immune from the challenges currently facing higher education in general, and private research institutions in particular, the accompanying financial statements show that it is well positioned to respond to them while advancing the important goals and objectives of its strategic plan.

Eugene S. Sunshine

Eugene S. Sunshine
Senior Vice President for Business and Finance

Investment Report

During the past fiscal year the US Federal Reserve's monetary policy continued to dominate global financial market news. Investors' concerns that the US central bank might reduce large-scale asset purchasing drove Treasury bond yields dramatically higher, and US government bonds had negative single-digit returns for fiscal year 2013. Global equities and equity-oriented asset classes, however, produced double-digit returns. As a result, the University's diversified portfolio gained 11.6 percent for fiscal year 2013. The Long-Term Balanced Pool rose by $664 million, to $7.85 billion. On August 31, 2013, the University's investment assets (including cash and intra-University investments) totaled $8.14 billion, an increase of $721 million over August 31, 2012.

The University's Total Investment Pools

The University maintains three primary investment pools: The Long-Term Balanced Pool, Treasury funds, and separately invested assets. Each investment category has a specific set of objectives.

The Long-Term Balanced Pool, used for endowed and quasi-endowed purposes, is managed with the objective of long-term total return. It is a "unitized fund" using mutual fund accounting principles. Because of its size and long-term orientation, performance data and investment strategy information in the discussion that follows relate to the Long-Term Balanced Pool.

Treasury funds are money market funds used for cash reserves and to preserve principal and maintain liquidity; intermediate-term bond investments; and working capital funds held by the University, which are generated through the temporary differences between operating receipts and disbursements. These funds are not unitized. The income from investing them is used for general operating purposes. Working capital investments are held in a variety of money market instruments or, if not needed within 90 days, are invested in the Long-Term Balanced Pool.

Separately invested funds are donated funds, including restricted investments and some life-income plans. These assets may not be merged with other assets for consolidated management.

The table below illustrates the net asset values and unitized information for the University's investment pools for the past five years.

History of the Merged Pools as of August 31, 2013

	2009	*2010*	*2011*	*2012*	*2013*
Long-Term Balanced Pool					
Net asset value *(in thousands of dollars)*	$5,639,701	$6,015,844	$7,012,867	$7,186,794	$7,850,651
Number of units *(in thousands)*	32,524	33,301	34,144	35,155	36,390
Net asset value per unit	$173.40	$180.65	$205.39	$204.43	$215.74
Payout amount per unit					
Current earned income	($0.50)	($0.71)	($0.75)	($0.75)	$0.11
Previously reinvested realized gains withdrawn	$9.04	$9.25	$9.03	$9.07	$8.63
Total payout per unit	$8.54	$8.54	$8.28	$8.32	$8.74
Summary of net asset values *(in thousands of dollars)*					
Treasury pool funds	$73,001	$117,334	$148,378	$146,675	$157,003
Separately invested funds	129,037	103,462	85,741	89,328	136,625
Total net asset value *(in thousands of dollars)*	**$5,841,739**	**$6,236,640**	**$7,246,986**	**$7,422,797**	**$8,144,279**

Asset Allocation for the Long-Term Balanced Pool

The Investments Committee of the University annually reviews asset allocation policy for the Long-Term Balanced Pool. In fiscal year 2013 the committee ratified the existing allocation targets based on the Investment Office's optimization modeling, which seeks to generate higher returns with lower risk levels. Subjective considerations such as liquidity and inflation/deflation protection were also part of the analysis.

The next chart displays the current asset allocation policy for the University. Reflecting the Investment Office's bias against market timing or tactical asset allocation as a primary driver of value added, actual allocations varied from targeted levels by modest amounts.

Policy Portfolio Targets and Ranges

	Range	*Target*	*August 31, 2013*	*Difference*
US equity	9–15%	12%	12.5%	0.5%
International equity	13–19%	16%	16.1%	0.1%
Fixed income	9–15%	12%	11.1%	-0.9%
High-yield credit	0–10%	5%	4.6%	-0.4%
Absolute return	14–22%	18%	16.7%	-1.3%
Private investments	16–24%	20%	20.8%	0.8%
Real assets	13–21%	17%	17.8%	0.8%
Cash		0%	0.4%	0.4%

Primary Investment Performance Objective: Preserving Purchasing Power and Growing Income

The principal objective for Northwestern's Long-Term Balanced Pool is to preserve purchasing power and to provide a growing stream of income to fund University programs. The pool seeks to achieve an annual total rate of return (i.e., actual income plus appreciation) equal to inflation plus actual spending. This objective of preserving purchasing power emphasizes the need for a long-term perspective in formulating both spending and investment policies. A more detailed look at the University's spending guideline is on page 6 of this report.

The University's investments have grown at a rate exceeding the objective. For the 12 months ended August 31, 2013, the portfolio increased 11.6 percent, outperforming the objective by 5.3 percent. For the 3-year, 10-year, and 15-year periods ended August 31, 2013, the portfolio outperformed the objective by 4.5 percent, 2.6 percent, and 2.3 percent, respectively.

Annualized Returns: Exceeding the Objective

	1-year	**3-year**	**5-year**	**10-year**	**15-year**
*Annual total return**	11.6%	11.6%	4.9%	9.6%	9.2%
– Spending	4.1%	4.1%	4.2%	4.0%	4.0%
– University management fee and support	0.7%	0.7%	0.6%	0.6%	0.6%
– Inflation	1.5%	2.3%	1.3%	2.4%	2.3%
= Above or below objective	**5.3%**	**4.5%**	**-1.2%**	**2.6%**	**2.3%**

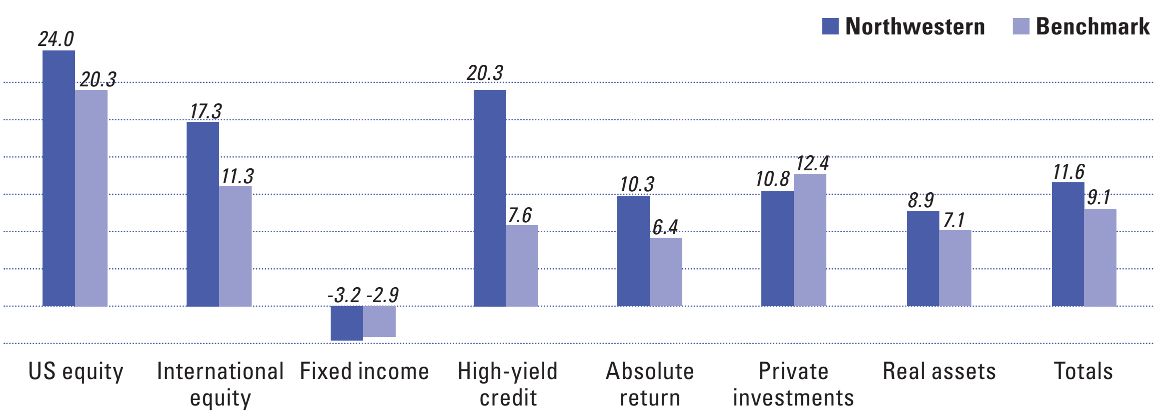
** Total returns are net of fees and are calculated on annual changes in net asset value. They may differ from payout distributions.*

Secondary Investment Performance Objective: Benchmark Comparisons

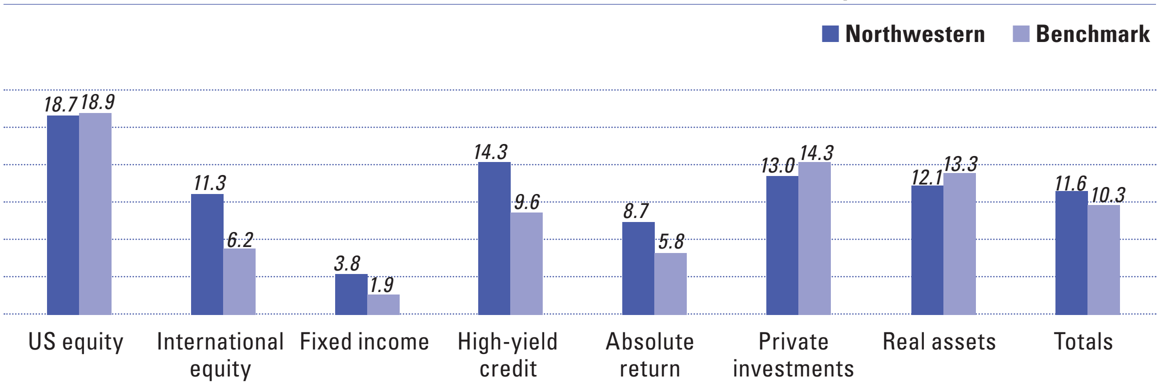
The pool's 11.6 percent return for the 12-month period outperformed the 9.1 percent return of its composite benchmark (a blend of the benchmark returns for each asset class weighted by the policy allocation targets). Outperformance was the result of five of the seven portfolios exceeding their benchmarks. The US equity portfolio in particular outperformed on a relative basis (24 percent versus 20.3 percent) and also was the best performer on an absolute basis. High-yield credit was the best performer on a relative basis (20.3 percent versus 7.6 percent), but its outperformance was counterbalanced by the underperformance of fixed income (-3.2 percent versus -2.9 percent). International equity, absolute return, and real assets outperformed their benchmarks by 6 percent, 3.9 percent, and 1.8 percent, respectively, while private investments underperformed by 1.6 percent. The first chart that follows shows returns and benchmarks for all asset classes for the fiscal year.

The second chart shows that the Long-Term Balanced Pool outperformed its composite benchmark (11.6 percent versus 10.3 percent) for the three-year period ended August 31, 2013. Four of the seven portfolios exceeded their benchmarks over three years, but US equity, private investments, and real assets underperformed. Five of the asset classes were double-digit performers, reflecting the recovery from the 2008–09 financial crisis. A more detailed explanation of activity and performance follows the three-year performance chart.

Long-Term Balanced Pool: Fiscal 2013 Net Performance Relative to Benchmarks (in percentages)



Long-Term Balanced Pool: Three-Year Net Performance Relative to Benchmarks (in percentages)



Marketable Securities Categories

US equity was the top-performing asset class in absolute terms during the fiscal year, gaining 24 percent. The portfolio also outperformed the 20.3 percent gain of its benchmark (Russell 3000), primarily due to strong management. The portfolio has slightly underperformed its benchmark over 3 years by .2 percent (18.7 percent versus 18.9 percent) but has outperformed in 8 of the last 12 fiscal years. On an absolute basis, US equity was the best-performing asset class over the 3-year period, during which the US stock market significantly outperformed all other asset classes.

One of the best-performing asset classes in relative terms, the international equity portfolio outperformed its benchmark (67 percent, MSCI EAFE Index; 33 percent, MSCI EM Index) by 6 percent as it gained 17.3 percent for the fiscal year. This portfolio was the best-performing asset class on a relative basis for the past three years, returning 11.3 percent, compared with its benchmark's return of 6.2 percent. This portfolio was helped by a heavier weight to smaller-cap foreign stocks and by outstanding management. It has outperformed in 10 of the last 12 fiscal years.

Only the fixed income portfolio declined in value during the fiscal year, as yields on US Treasuries rose significantly. It underperformed on an absolute and relative basis, returning -3.2 percent, versus -2.9 percent for its benchmark (Barclays Government Index). The Investment Office helped returns by underweighting the portfolio and maintaining a shorter duration. For the last three years fixed income outperformed on a relative basis, returning 3.8 percent versus 1.9 percent for its benchmark. It has outperformed in 8 out of the last 12 fiscal years due to superior active management and exposure to global and inflation-protected bonds.

High-Yield Credit Category

The high-yield credit portfolio includes investments in distressed debt and other credit instruments with fixed income characteristics but more specific risk tied to the securities and their underlying cash flows. The portfolio was the top-performing asset class on a relative basis during the fiscal year, increasing 20.3 percent, compared with 7.6 percent for its benchmark (Merrill Lynch High-Yield Master II Index). On an absolute basis it was the second-best performer, returning 14.3 percent (versus 9.6 percent for its benchmark) for the three-year period. The portfolio has a conservative concentration of safer bank loans, which significantly outperformed the more risky high-yield bonds in the benchmark index. Cash flows were very strong for the current fiscal year, as distressed managers continued to return capital. The portfolio was cash-flow positive (total distributions less new investments or capital calls), with distributions of $137.1 million and capital calls of $25.5 million, for a net cash flow of $111.6 million.

Absolute Return Category

Made up of 26 different hedge funds, this portfolio aims to provide equity-like returns with low correlation to the equity markets. For the year it gained 10.3 percent, surpassing the 6.4 percent return of its benchmark (80 percent Treasury bills plus 400 basis points; 20 percent MSCI All-Country World Index). The portfolio's three-year return of 8.7 percent exceeded its benchmark's return of 5.8 percent. Northwestern's absolute return portfolio is weighted toward long-short equity managers (40 percent), but the University has been reducing this exposure by increasing the allocation in other hedge-fund strategies. The remaining hedge funds (60 percent) are less equity-market sensitive and represent diversifying strategies, and the University intends to increase exposure to such funds in fiscal year 2014.

Private Investments Category

The private investments portfolio includes investments in global buyout, growth equity, and venture capital funds. This portfolio had a double-digit return of 10.8 percent for the fiscal year; however, on a relative basis, it underperformed the 12.4 percent return of its benchmark (Cambridge Associates Private Investments). For the three-year period, it was a strong peformer, gaining 13 percent due to increased profitability at underlying portfolio companies and merger and acquisition activity. In addition, the initial public offering environment significantly improved worldwide.

Cash flows were strong for the second consecutive fiscal year. The portfolio continued to experience an increase in trade sales, recapitalizations, and public offerings, resulting in more distributions from the portfolio companies. For fiscal year 2013 private investment distributions were $350.8 million and capital calls $176.6 million, for a net cash flow of $174.2 million. The University's manager relationships and reputation in the marketplace remain strong.

Real Assets Category

The real assets portfolio includes the University's investments in energy, timber, real estate, and public investments in commodity funds. This portfolio outperformed its benchmark (a mix of energy, real estate, and commodities) return on a relative basis in fiscal year 2013, gaining 8.9 percent (versus 7.1 percent). It was a strong performer for the three-year period, gaining 12.1 percent. Distribution activity significantly increased in particular, as there continued to be substantially higher realizations in private-partnership real estate and energy investments. With distributions of $295.6 million and capital calls of $220.6 million, the net cash flow was $75 million for fiscal year 2013.

Long-Term Balanced Pool Spending Guideline

To sustain the Long-Term Balanced Pool's long-term earning ability and provide adequate resources to the University, the Board of Trustees in fiscal year 2006 ratified a revised spending guideline that blends two elements:

- Market element adjusts annual endowment spending to the long-term sustainable target spending of 4.35 percent of the average actual market value of the endowment for the 12 months ended October 31 of the prior fiscal year. This component of the spending rate receives a 30 percent weighting in the spending rate calculation.
- Spending element increases the previous year's spending rate by actual inflation plus budget growth (1.5 percent). This element of the spending rate receives a weight of 70 percent.

The spending rate for fiscal year 2013 was 4.1 percent. The amount per unit for fiscal year 2014, calculated using the guideline above, is $8.93.

Payout Determined by Spending Guideline

	2009	*2010*	*2011*	*2012*	*2013*
Spending per unit	$8.54	$8.54	$8.28	$8.32	$8.74
Net asset value per unit	$173.40	$180.65	$205.39	$204.43	$215.74
Annual spending rate*	4.24%	4.71%	4.20%	3.98%	4.08%
Total (in millions)	$272.95	$281.91	$279.61	$288.30	$313.17
Growth in total spending	16.90%	3.28%	-0.81%	3.11%	8.62%

** Annual spending rate is calculated as spending per unit divided by the two-year average net asset value per unit after distribution of the annual contribution to the budget.*

The Long-Term Balanced Pool: In Conclusion

Northwestern's portfolio delivered strong performance for the fiscal year and is poised to continue to grow and support the University's needs. Its success is based on the diversification of the Long-Term Balanced Pool and the skill of outstanding money managers worldwide in meeting investment objectives over long time horizons. Northwestern's leadership continues to maintain a long-term investment focus and remains confident in the portfolio's prospects.

William H. McLean

William H. McLean
Vice President and Chief Investment Officer

Report of Independent Auditors

To the Board of Trustees of Northwestern University:

We have audited the accompanying consolidated financial statements of Northwestern University (the "University"), which comprise the consolidated statement of financial position as of August 31, 2013, and the related consolidated statements of activities, and of cash flows for the year then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 Northwestern University at August 31, 2013, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

We have previously audited Northwestern University's August 31, 2012 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated January 9, 2013. In our opinion, the summarized comparative information presented herein as of and for the year ended August 31, 2012 is consistent, in all material respects, with the audited financial statements from which it has been derived.

PricewaterhouseCoopers LLP

Chicago, Illinois

January 13, 2014

Consolidated Statements of Financial Position

As of August 31, 2013, and August 31, 2012

(in thousands of dollars)	*2013*	*2012*
Assets		
Cash and cash equivalents	$830,383	$613,731
Accounts receivable, *net*	260,713	275,488
Notes receivable, *net*	89,789	75,762
Contributions receivable, *net*	116,395	99,289
Investments	7,917,622	7,220,057
Land, buildings, and equipment, *net*	1,683,639	1,576,025
Other assets	18,619	16,545
Total assets	**$10,917,160**	**$9,876,897**
Liabilities		
Accounts payable and accrued expenses	$218,444	$245,282
Deferred revenue	260,684	252,333
Deposits payable and actuarial liability of annuities payable	165,773	113,058
Government advances for student loans	38,748	38,738
Asset retirement obligations	132,057	129,842
Bonds, notes, and other debt payable	948,966	972,310
Total liabilities	**$1,764,672**	**$1,751,563**
Net assets		
Unrestricted	$5,744,796	$4,952,584
Temporarily restricted	2,226,495	2,047,109
Permanently restricted	1,181,197	1,125,641
Total net assets	**$9,152,488**	**$8,125,334**
Total liabilities and net assets	**$10,917,160**	**$9,876,897**

See Notes to the Consolidated Financial Statements, beginning on page 12.

Consolidated Statements of Activities

For the fiscal year ended August 31, 2013, and summarized financial information for the fiscal year ended August 31, 2012

(in thousands of dollars)	2013				2012
Operating revenues	**Unrestricted**	**Temporarily restricted**	**Permanently restricted**	**Total**	**Total**
Tuition and fees	$840,247			$840,247	$799,143
(less scholarships and fellowships)	(295,942)			(295,942)	(270,215)
Net tuition and fees	544,305			544,305	528,928
Auxiliary services	76,980			76,980	76,507
Grants and contracts	542,847			542,847	535,049
Private gifts	175,882			175,882	108,178
Investment return designated for operations	264,988	$124,999		389,987	351,365
Sales and services	138,145			138,145	149,303
Professional fees	26,638			26,638	32,354
Royalties and trademarks	411,389			411,389	122,488
Other income	524			524	4,216
Total operating revenues	**2,181,698**	**124,999**	**—**	**2,306,697**	**1,908,388**
Net assets released from restrictions	**195,387**	**(195,387)**		**—**	**—**
Total operating revenues and other additions (reductions)	**2,377,085**	**(70,388)**	**—**	**2,306,697**	**1,908,388**
Operating expenses					
Salaries, wages, and benefits	1,051,137			1,051,137	994,409
Services, supplies, travel, and other	507,842			507,842	468,130
Depreciation and ARO accretion	110,389			110,389	111,474
Operations of plant, rent, and equipment	88,617			88,617	82,434
Utilities and communications	56,611			56,611	58,151
Trademark and royalty fees	45,629			45,629	42,130
Interest on indebtedness	39,076			39,076	34,723
Total operating expenses	**1,899,301**	**—**	**—**	**1,899,301**	**1,791,451**
Excess (deficit) of operating revenues over expenses	**477,784**	**(70,388)**	**—**	**407,396**	**116,937**
Nonoperating revenues and expenses					
Private gifts and grants for buildings and equipment	5,592	3,187		8,779	16,644
Restricted private gifts		85,133	$50,919	136,052	134,894
Net gain (loss) on annuity obligations		1,907	4,637	6,544	(1,510)
Investment returns, reduced by operating distribution	269,290	159,547		428,837	46,937
Change in value of derivative instruments	40,334			40,334	(20,045)
Other nonoperating expenses	(788)			(788)	—
Excess of nonoperating revenues over expenses	**314,428**	**249,774**	**55,556**	**619,758**	**176,920**
Change in net assets	**792,212**	**179,386**	**55,556**	**1,027,154**	**293,857**
Beginning net assets	**4,952,584**	**2,047,109**	**1,125,641**	**8,125,334**	**7,831,477**
Ending net assets	**$5,744,796**	**$2,226,495**	**$1,181,197**	**$9,152,488**	**$8,125,334**

See Notes to the Consolidated Financial Statements, beginning on page 12.

Consolidated Statements of Cash Flows

For the fiscal years ended August 31, 2013, and August 31, 2012

(in thousands of dollars)	*2013*	*2012*
Cash flows from operating activities		
Change in net assets	**$1,027,154**	**$293,857**
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities		
Depreciation	107,327	105,582
Accretion for asset retirement obligations	6,189	5,892
Asset retirement obligations reduction	(3,974)	—
Net losses on retirements and sales of buildings and equipment	2,834	359
Net amortization of discounts (and accretion) of premiums on bonds payable	(79)	(79)
Allowance for student loans receivable	545	(152)
Net realized and unrealized gains on investments	(736,666)	(357,095)
Contributed securities	26,747	22,097
Change in value of derivative instruments	(40,334)	20,045
Private gifts and grants for buildings and equipment	(8,779)	(16,644)
Changes in assets and liabilities		
Accounts receivable	15,040	51,781
Contributions receivable	(17,106)	(37,948)
Other assets	(2,072)	376
Accounts payable and accrued expenses	4,293	5,244
Deferred revenue	8,351	(56,691)
Government advances for student loans	10	(230)
Net cash provided by operating activities	**389,480**	**36,394**
Cash flows from (used in) investing activities		
Purchases of investments	(1,991,556)	(1,275,520)
Proceeds from sales of investments	2,011,645	1,437,077
Acquisitions of land, buildings, and equipment	(208,650)	(148,164)
Proceeds from sale of buildings or equipment	78	240
Student loans disbursed	(22,130)	(18,023)
Principal collected on student loans	7,558	916
Other	(8,000)	(8,558)
Net cash used in investing activities	**(211,055)**	**(12,032)**
Cash flows from (used in) financing activities		
Net proceeds from issuance of bonds payable	—	200,000
Principal payments on notes, bonds, and other debt payable	(23,265)	(3,070)
Proceeds from private gifts and grants for buildings and equipment	8,779	16,644
Increase in deposits payable and annuities payable	52,713	35,171
Net cash provided by financing activities	**38,227**	**248,745**
Increase in cash and cash equivalents	**216,652**	**273,107**
Cash and cash equivalents at beginning of year	**613,731**	**340,624**
Cash and cash equivalents at end of year	**$830,383**	**$613,731**
Supplemental disclosure of cash flow information		
Accrued liabilities for construction in progress	$18,134	$8,960
Capitalized interest	6,983	5,536
Cash paid for interest	39,201	32,595

See Notes to the Consolidated Financial Statements, beginning on page 12.

1. Summary of Significant Accounting Policies

University Activities

Northwestern University (the University) is a major private research university with more than 17,000 students enrolled in 11 academic divisions on two lakefront campuses in Evanston and Chicago and an international campus in Doha, Qatar.

Northwestern's mission is to provide the highest-quality education for its students, to develop innovative programs in research, and to sustain an academic community that embraces these enterprises. Activities supporting its mission may be classified as either operating or nonoperating. Operating revenues include student tuition, research funding, investment return designated for operations, educational sales and services, private gifts, royalties, and auxiliary services. Operating expenses reflect support for all functions of the University. Nonoperating activities include unrealized gains and losses on investments, temporarily restricted gifts for building, and all permanently restricted endowment gifts.

Basis of Accounting

General

The University maintains its accounts and prepares its consolidated financial statements on the accrual basis of accounting in conformity with generally accepted accounting principles in the United States of America (GAAP). The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) is the source of authoritative GAAP. The University prepares its consolidated financial statements in accordance with the Not-for-Profit Entities Topic of the FASB ASC. These statements include all wholly owned subsidiaries. All significant intercompany transactions and accounts have been eliminated.

Net Asset Classifications

Net assets and the flow of those net assets are classified in three net asset categories according to the existence or absence of donor-imposed restrictions. For further discussion of the classification of donor-restricted endowment funds and disclosures about both donor-restricted and board-designated endowment funds, see note 9.

The category *Permanently Restricted Net Assets* applies to gifts, trusts, and pledges whose donors required that the principal be held in perpetuity and that only the income be available for stipulated program operations.

The category *Temporarily Restricted Net Assets* includes gifts for which donor-imposed restrictions have not been met (these are primarily future capital projects), as well as trust activity and pledges receivable whose ultimate use is not permanently restricted. In addition, the excess of the fair value over the historical cost of permanently restricted endowments is classified as temporarily restricted net assets until appropriated for expenditure.

The category *Unrestricted Net Assets* describes funds that are legally available for any purpose and have no donor-imposed restrictions. All revenues, expenses, gains, and losses are classified as unrestricted net assets unless they are changes in temporarily or permanently restricted net assets. Net unrealized losses on permanently restricted endowment funds for which the historical cost exceeds fair value are recorded as a reduction to unrestricted net assets.

Revenue from temporarily restricted sources is reclassified as unrestricted income when the circumstances of the restriction have been fulfilled. Donor-restricted revenues whose restrictions are met within the same fiscal year are reported as unrestricted income. The expiration of a donor-imposed restriction on a contribution is recognized in the period in which the restriction expires. All expenditures are reported in the unrestricted class of net assets, since the use of restricted contributions in accordance with the donor's stipulations causes the release of the restriction. Donor-restricted purposes include instruction, research, library collections, scholarship and awards, and building construction.

Fair Value Measurements

The University makes fair value measurements and enhanced disclosures about fair value measurements as required by the Fair Value Measurements and Disclosures Topic of the FASB ASC. For further discussion, see note 4.

Cash and Cash Equivalents

Cash reflects currency and deposits or other accounts with financial institutions that may be deposited or withdrawn without restriction or penalty. *Cash equivalents* represent short-term and highly liquid investments that convert readily to cash and carry little risk of change in value at maturity due to interest-rate changes; maturities of the investments are three months or less at the date of purchase.

Contributions

Contributions received, including unconditional promises to give (pledges), are recognized by the University as revenues at their fair values. Private gifts, including unconditional promises to give, are recognized as revenues in the period received. Conditional promises to give are not included in revenue until the conditions are substantially met.

Investments

Investments in securities and financial instruments are recorded at fair value. The University values its investments using a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the reporting entity; unobservable inputs reflect the entity's own assumptions about how market participants would value an asset or a liability based on the best information available. Valuation techniques used to measure fair value must 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 unobservable, that may be used to measure fair value. The following describes this hierarchy and the primary valuation methodologies used by the University for financial instruments measured at fair value on a recurring basis:

Level 1: Quoted prices in active markets for identical assets or liabilities. Market-price data are generally obtained from relevant exchanges or dealer markets.

Level 2: Inputs other than Level 1 that are observable either directly or indirectly, such as quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially all of the same term of the assets or liabilities. Inputs are obtained from various sources, including market participants, dealers, and brokers.

Level 3: Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities.

A financial instrument's categorization within the valuation hierarchy is based on the lowest level of input significant to the fair value measurement. The categorization of an investment is based on its pricing transparency and liquidity and does not necessarily correspond to the University's perceived risk of that investment.

Equity securities with readily determinable fair values and debt securities are valued at the last sale price (if quotations are readily available) or at the closing bid price in the principal market in which such securities are normally traded (if no sale price is available). The fair values for these securities are classified as Level 1 because the securities have observable market inputs. Certain fixed income securities are valued based on dealer-supplied valuations; since these securities have significant other observable inputs, they are classified as Level 2.

The estimated fair values of equity securities that do not have readily determined fair values, and of other investments, are based on estimates provided by external investment managers. The guidance permits an entity, as a practical expedient, to measure the fair value of such investments based on the net asset value (NAV) per share. These estimates are examined through a valuation review process performed by management. These investments are generally less liquid than other investments. The fair values for these securities are classified as Level 3, reflecting significant unobservable inputs that are supported by little or no market inputs. The fair values of investments based on NAV are categorized as Level 2 if the investments are redeemable at the reporting date or within the near term, defined by the University as within 90 days of the reporting date.

Investments in certain real assets and other investments are recorded at acquisition or contruction cost, or at fair value as of donation date if received as a contribution. The University performs a periodic assessment of these assets for impairment by comparing the future cash flows expected from the asset to the carrying value of the asset. An impairment loss is recognized for the difference between estimated fair value and carrying value. In management's opinion, no impairment of investments held at cost existed as of August 31, 2013. For further discussion of such investments, see note 4.

The methods described above may produce a fair value that may not be indicative of net realizable value or of future fair values. Furthermore, while the University believes its valuation methods are appropriate and consistent with those of 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.

Investment income is recorded on the accrual basis, and purchases and sales of investment securities are reflected on a trade-date basis.

Derivative Financial Instruments

The University uses various financial instruments to obtain equity market exposure (e.g., equity price risk) of an underlying investment strategy; if applicable, these have a reference index (e.g., S&P 500) that is the same, or highly correlated with, the reference index of the investment strategy. Such instruments are not designated as hedges for accounting purposes and are recorded at fair value.

The University enters into swap agreements to hedge future interest-rate movements. It may also add various interest-rate options to hedge the overall portfolio and use an interest-rate swap agreement to hedge variable interest-rate exposure. Interest-rate swaps are valued using observable inputs, such as quotations received from the counterparty, dealers, or brokers, whenever they are available and considered reliable. If and when models are used, the value of the interest-rate swap depends on the contractual terms of and specific risks inherent in the instrument, as well as the availability and reliability of observable inputs. Such inputs include market prices for reference securities, yield curves, credit curves, measures of volatility, prepayment rates, and correlations of such inputs. The interest-rate swaps classified within Level 3 have unobservable inputs with little or no market activity. For further discussion, see notes 4 and 8.

Fair Values of Financial Instruments Other Than Investments

The fair values of financial instruments other than investments are based on a variety of factors. In some cases, fair values represent quoted market prices for identical or comparable instruments. In other cases, fair values have been estimated based on assumptions about the amount and timing of estimated future cash flows and assumed discount rates reflecting varying degrees of risk. Accordingly, the fair values may not represent actual values that could have been realized at year-end or that will be realized in the future.

Accounts and Notes Receivable

Accounts receivable are recorded at net realizable value. Those generally expected to be collected within one year are carried without an allowance. The allowance for student accounts receivable is based on an analysis of outstanding account balances and is calculated using percentages based on historical collection data applied to the outstanding accounts receivable balances. Accounts receivable deemed to be uncollectible are expensed at that time.

Notes receivable are recorded at net realizable value and are predominantly student loans with varying maturities. Notes receivable deemed to be uncollectible are expensed at that time.

Management assesses the adequacy of the allowance for credit losses on a regular basis by performing ongoing analysis of the student loan portfolio. Factors considered are differing economic risks associated with each loan category, the financial condition of specific borrowers, the economic environment in which the borrowers operate, the level of delinquent loans, and other significant influences. Loans disbursed under federally guaranteed student loan programs have special provisions. Based on this evaluation and management judgment, an uncollectible percentage is calculated and applied to each category of student loan balances outstanding. Management considers the allowance for student loan portfolio credit losses to be prudent and reasonable.

Contributions Receivable

Contributions receivable arising from unconditional promises to give are carried net of an allowance for uncollectible pledges. Additionally, unconditional promises are presented at estimated fair value considering duration and collection risk. There were no significant conditional promises to give as of August 31, 2013, and August 31, 2012.

Land, Buildings, and Equipment

The value of land, buildings, and equipment is recorded at cost or, if received as gifts, at fair value at the date of the gift. Significant renewals and replacements are capitalized. The cost of repairs and maintenance is expensed as incurred. Purchases of library books and works of art are also expensed.

Depreciation is calculated using the straight-line method over the useful lives of the equipment, which are estimated to be 3 to 20 years; of the buildings and land improvements, which are estimated to be up to 40 years; and of the leasehold improvements, which are estimated to be the shorter of the useful life or the lease term. The useful life of land is deemed indefinite and not depreciable.

The University reviews long-lived assets for impairment by comparing the future cash flows expected from the asset to the carrying value of the asset. If the carrying value of an asset exceeds the sum of estimated undiscounted future cash flows, an impairment loss is recognized for the difference between estimated fair value and carrying value. In management's opinion, no impairment existed as of August 31, 2013.

Charitable Remainder Trusts

Charitable remainder trusts are classified as permanently restricted net assets if, upon termination of the trust, the donor permanently restricts the remaining trust assets. If the remainder is not permanently restricted by the donor, the charitable remainder trust assets are recorded as temporarily restricted net assets.

Annuities Payable

Annuities payable consist of annuity payments currently due and the actuarial amount of annuities payable. The actuarial amount of annuities payable is the present value of the aggregate liability for annuity payments over the expected lives of the beneficiaries.

Self-Insurance Reserves

The University maintains a self-insurance program for general liability, professional liability, and certain employee and student insurance coverages. This program is supplemented with commercial excess insurance above the University's self-insurance retention. The reserves for self-insurance and postretirement medical and life insurance benefits are based on actuarial studies and management estimates. See note 12 for additional discussion.

Asset Retirement Obligations

The University records all known asset retirement obligations (ARO) for which the fair value of the liability can be reasonably estimated, including certain obligations relating to regulatory remediation. Asset retirement obligations covered include those for which an entity has a legal obligation to perform an asset retirement activity; however, the timing and/or method of settling the obligation are conditional on a future event that may or may not be within the control of the entity. The reserves for asset retirement obligations are based on analyses of University assets, review of applicable regulatory and other guidance, and management estimates.

Revenue Recognition

Revenues from tuition and fees are reported in the fiscal year in which they are earned, including pro-rata adjustments for educational programs crossing over fiscal years. Fiscal year 2014 fall-quarter tuition and fees, billed but not collected in fiscal year 2013, are reported as deferred revenue in fiscal year 2013. Similarly, fiscal year 2013 fall-quarter tuition and fees, billed but not collected in fiscal year 2012, are reported as deferred revenue in fiscal year 2012.

Revenues from auxiliary services, such as residence and food services, represent fees for goods and services furnished to University students, faculty, and staff; these revenues are recognized in the fiscal year in which the goods and services are provided. Grants and contracts revenue is recognized as expenses are incurred on a project. Professional fees arise from faculty and department services provided to external institutions such as hospitals. Sales and services revenues represent fees for services and goods provided to external parties in the course of educational activities and also include revenues from the provision of physical plant services and goods to external institutions contiguous to the University campuses. Trademark and royalty revenues arise from licensing of innovative technologies, copyrights, and other intellectual property; these revenues are recognized in the fiscal year in which they are earned. Other income includes revenues not otherwise categorized that are also recognized in the fiscal year in which they are earned.

Federal Grants and Contracts Revenue

The University receives funding or reimbursement from federal agencies. In addition, indirect cost recovery on federal grants and contracts is based on an institutional rate negotiated with its cognizant federal agency, the United States Department of Health and Human Services.

Income Taxes

The Internal Revenue Service has determined that the University is exempt from income taxes under Section 501(c)(3) of the US Internal Revenue Code, except with regard to unrelated business income, which is taxed at corporate income tax rates. The University files federal and various state and local tax returns. The statute of limitations on the University's federal tax returns remains open for fiscal years 2010 through 2013.

The University makes an assessment of individual tax positions and follows a process for recognition and measurement of uncertain tax positions. Tax positions are evaluated on whether they meet the "more likely than not" standard for sustainability on examination by tax authorities.

Uses of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities; the disclosure of contingent assets and liabilities at the date of the consolidated financial statements; and the reported amounts of revenues and expenses during the relevant period. Actual results could differ from those estimates.

The University believes that the methods and assumptions used in computing these reserves and liabilities are appropriate.

Recent Accounting Pronouncements

Accounting Standard Update (ASU) 2011–04 was issued May 12, 2011, and amends the Fair Value Measurement Topic to clarify and define common principles and requirements for measuring fair value and for disclosing information about fair value measurements. The University implemented these new disclosures in fiscal 2013.

Summarized Comparative Information

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 GAAP. Accordingly, such information should be read in conjunction with the University's financial statements for the year ended August 31, 2012, from which the summarized information was derived.

Revision and Reclassifications

In 2013, the University began separately reporting unrealized gains and losses on derivative instruments within nonoperating revenues and expenses on the consolidated statements of activities and as an operating activity on the consolidated statements of cash flows. The University revised the 2012 consolidated statements of activities and the consolidated statements of cash flows to correctly report net unrealized losses on certain derivative instruments totaling $20 million as a separate line item within nonoperating revenues and expenses on the consolidated statement of activiities and as cash flow from operating activity on the consolidated statements of cash flows. The University believes the prior year consolidated financial statements were not materially misstated.

Certain fiscal year 2012 amounts have been reclassified in the operating expenses by natural classification on the consolidated statements of activity. Functional expenses are disclosed in note 14.

2. Accounts Receivable and Notes Receivable

Accounts receivable are summarized on the consolidated statements of financial position as follows:

(in thousands of dollars)	*August 31, 2013*	*August 31, 2012*
Research and other sponsored programs support	$65,467	$71,272
Student receivables	86,421	87,333
Royalty receivables	41,208	50,339
Other receivables	68,194	67,069
Accounts receivable subtotal	**261,290**	**276,013**
Less allowances for student uncollectible amounts	(577)	(525)
Total accounts receivable	**$260,713**	**$275,488**

Notes receivable are summarized on the consolidated statements of financial position as follows:

(in thousands of dollars)	*August 31, 2013*	*August 31, 2012*
Notes receivable	$91,300	$76,728
Less allowances for student uncollectible amounts	(1,511)	(966)
Total notes receivable	**$89,789**	**$75,762**

Activity within the allowances was insignificant for fiscal years 2013 and 2012.

3. Contributions Receivable

Contributions receivable consisted of the following:

(in thousands of dollars)	*August 31, 2013*	*August 31, 2012*
Unconditional promises expected to be collected in		
Less than one year	$44,421	$42,958
One year to five years	79,729	65,048
More than five years	5,689	5,188
Less discount to present value and other reserves		
Discount to present value	(5,705)	(4,413)
Other reserves	(7,739)	(9,492)
Total contributions receivable	**$116,395**	**$99,289**

Contributions receivable are discounted based on the weighted average borrowing rates for short-term and long-term bonds, notes, and other debt payable to correspond to the terms of the pledges receivable. The discount rate for pledges made in fiscal years 2013 through 2011 was 2.7 percent; the discount rate for pledges made in prior fiscal years ranged from 2.9 to 6.5 percent. The University deems these yields to be a Level 3 input.

The table below summarizes the change in contributions receivable for the fiscal years ended August 31, 2013, and 2012.

(in thousands of dollars)	*2013*	*2012*
Balance—beginning of year	$99,289	$61,341
New pledges	65,574	80,564
Collections on pledges	(48,138)	(41,547)
Adjustments to pledges	(791)	(4,234)
Increase in discount to present value	(1,292)	(1,952)
Decrease in other reserves	1,753	5,117
Balance at end of year	**$116,395**	**$99,289**

4. Investments

The University's investments are overseen by the Investments Committee of the Board of Trustees. Guided by the policies established by the Investments Committee, the University's Investment Office or external equity investment managers, external and internal fixed income and cash managers, and various limited partnership managers direct the investment of endowment and trust assets, certain working capital, temporarily invested expendable funds, and commercial real estate.

Substantially all of these assets are merged into internally managed investment pools on a market value basis. Each holder of units in the investment pools subscribes to or disposes of units on the basis of the market value per unit at the beginning of each month.

Investment Fair Value

The following charts show the estimated fair value of investments and derivatives and also investments held at cost, grouped by the valuation hierarchy as defined in note 1, for the fiscal years ended August 31, 2013, and 2012:

(in thousands of dollars) *August 31, 2013*

	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total fair value
US equity securities	$408,307	$125,431	$463,352	$997,090
International equity	314,919	342,573	478,435	1,135,927
Fixed income	—	828,375	74,771	903,146
High-yield credit	—	—	368,211	368,211
Absolute return	—	305,220	1,019,935	1,325,155
Private investments	176	—	1,719,232	1,719,408
Real assets	—	68,132	1,339,894	1,408,026
Other investments	—	3,464	19,363	22,827
Subtotal investment assets at fair value	**723,402**	**1,673,195**	**5,483,193**	**7,879,790**
Investments held at cost	—	—	35,531	35,531
Interest-rate derivatives	—	—	2,301	2,301
Subtotal investments	**723,402**	**1,673,195**	**5,521,025**	**7,917,622**
Interest-rate swaps	—	—	(30,769)	(30,769)
Total	**$723,402**	**$1,673,195**	**$5,490,256**	**$7,886,853**

(in thousands of dollars) *August 31, 2012*

	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total fair value
US equity securities	$266,249	$182,818	$391,725	$840,792
International equity	289,446	277,381	325,420	892,247
Fixed income	6,211	707,195	139,524	852,930
High-yield credit	—	—	417,340	417,340
Absolute return	—	256,067	870,174	1,126,241
Private investments	229	—	1,666,530	1,666,759
Real assets	80,969	3,130	1,281,220	1,365,319
Other investments	10,210	2,685	18,458	31,353
Subtotal investment assets at fair value	**653,314**	**1,429,276**	**5,110,391**	**7,192,981**
Investments held at cost	—	—	36,602	36,602
Interest-rate derivatives	—	—	(9,526)	(9,526)
Subtotal investments	**653,314**	**1,429,276**	**5,137,467**	**7,220,057**
Interest-rate swaps	—	—	(71,103)	(71,103)
Total	**$653,314**	**$1,429,276**	**$5,066,364**	**$7,148,954**

Investments included in Level 3 consist primarily of the University's ownership in alternative investments (principally limited partnership interests in hedge, private equity, real estate, and other similar funds). As a practical expedient, when quoted market prices are not available, the estimated fair values of these investments are generally based on reported partners' capital or NAV provided by the associated external investment managers. Since a range of possible values exists for these partnership investments, the estimated values may be materially different from the values that would have been used had a ready market for these partnerships existed. The University exercises diligence in assessing the policies, procedures, and controls of external investment managers; management's assessment includes a valuation review process of the most recent available audited and unaudited financial statements and discussions with the majority of external investment managers about the aggregate carrying value of the respective investments at August 31, 2013. The assessment may result in adjustment to the external managers' valuations of the securities' fair value. Management reviewed the valuation policies for all partnerships in which the University is invested and deemed that its policies are appropriate and that the carrying amount of these assets represents a reasonable estimate of fair value. A small number of investments within certain partnerships may have holdings at a carrying value of cost. In the absence of another basis, management has determined this method to be appropriate for these specific investments and representative of an approximation of the fair value.

For fiscal years ended August 31, 2013, and 2012, investments held at cost included in Level 3 are real estate totaling $19.4 million, property co-ownerships totaling $13.7 million and $14.7 million, and mortgages and other investments totaling $2.4 million and $2.5 million, respectively.

The following tables summarize changes in the investments and derivatives classified by the University in Level 3 of the fair value hierarchy for the fiscal years ended August 31, 2013, and 2012:

(in thousands of dollars)	*August 31, 2012*							*August 31, 2013*
	Fair value	**Purchases**	**Sales and settlements**	**Unrealized gains (losses)**	**Realized gains (losses)**	**Transfers into and out of Level 3**	**Reclassifications**	**Fair value**
US equity securities	$391,725	50,000	(64,972)	84,638	1,961			$463,352
International equity	325,420	52,168	(31,074)	58,217	12,714	516	60,474	478,435
Fixed income	139,524			(4,287)			(60,466)	74,771
High-yield credit	417,340	23,900	(92,337)	19,308				368,211
Absolute return	870,174	167,025	(72,036)	37,469	17,303			1,019,935
Private investments	1,666,530	200,813	(220,681)	38,777	33,801		(8)	1,719,232
Real assets	1,281,220	209,825	(198,103)	46,649	303			1,339,894
Other investments	18,458	695	(56)	266				19,363
Total investments	**5,110,391**	**704,426**	**(679,259)**	**281,037**	**66,082**	**516**	**—**	**5,483,193**
Investments held at cost	36,602	268	(1,339)					35,531
Interest-rate derivatives	(9,526)			11,827				2,301
Interest-rate swaps	(71,103)			40,334				(30,769)
Total	**$5,066,364**	**704,694**	**(680,598)**	**333,198**	**66,082**	**516**	**—**	**$5,490,256**

(in thousands of dollars)	August 31, 2011							August 31, 2012
	Fair value	Purchases	Sales and settlements	Unrealized gains (losses)	Realized gains (losses)	Transfers into and out of Level 3	Reclassifications	Fair value
US equity securities	$359,119		(29,167)	61,773				$391,725
International equity	296,619	5,502	(9,392)	33,279	(588)			325,420
Fixed income	134,126			5,398				139,524
High-yield credit	538,608	31,284	(82,836)	29,189	1,938		(100,843)	417,340
Absolute return	811,379	14,000	(113,053)	49,851	7,154		100,843	870,174
Private investments	1,633,500	396,120	(423,200)	4,535	55,567	8		1,666,530
Real assets	1,236,579	214,224	(141,454)	(24,419)	(3,710)			1,281,220
Other investments	16,950	1,508		18	(18)			18,458
Total investments	**5,026,880**	**662,638**	**(799,102)**	**159,624**	**60,343**	**8**	**—**	**5,110,391**
Investments held at cost	35,771	2,023	(1,192)					36,602
Interest-rate derivatives	(2,767)			(6,759)				(9,526)
Interest-rate swaps	(51,058)			(20,045)				(71,103)
Total	**$5,008,826**	**664,661**	**(800,294)**	**132,820**	**60,343**	**8**	**—**	**$5,066,364**

There were no significant transfers or reclassifications between Levels 1 and 2 during fiscal year 2013.

The next table presents funding obligations and redemption terms of investments by asset class. The University is required under certain partnership agreements to advance additional funding up to specified levels over a period of several years. These uncalled commitments have fixed expiration dates and other termination clauses. At August 31, 2013, the University was committed to making future capital contributions in the amount of $1,160.4 million, primarily in the next five years, as detailed below. Certain agreements also contain notice periods, lock-ups, and gates that limit the University's ability to initiate redemptions.

(in thousands of dollars)

	Fair value	Remaining life	Uncalled commitments	Redemption terms	Redemption restrictions
US equity securities	$997,090	No limit	—	Daily to annually, with 1–90-day notice periods	Lock-up provisions ranging from none to 5 years
International equity	1,135,927	No limit	8,200	Daily to annually, with 1–93-day notice periods	Lock-up provisions ranging from none to 5 years
Fixed income	903,146	No limit	—	Daily to quarterly, with 1–90-day notice periods	Lock-up provisions ranging from none to 3 years
High-yield credit	368,211	No limit to 8 years	62,486	Certain partnerships ineligible for redemption; other funds monthly to annually, with 30–90-day notice periods	Certain partnerships not redeemable; lock-up provisions on all other funds ranging from none to 2 years
Absolute return	1,325,155	No limit	—	Monthly to annually, with 5–120-day notice periods	Lock-up provisions ranging from none to 5 years; side pockets on many funds
Private investments	1,719,408	1–12 years	549,530	Partnerships ineligible for redemption	Not redeemable
Real assets	1,408,026	No limit to 14 years	540,197	Partnerships ineligible for redemption; commodity funds daily to annually, with 3–30-day notice periods	Partnerships not redeemable; no restrictions on commodity funds

Northwestern's marketable securities categories include investments in US equities, international equity, and fixed income strategies via separately managed accounts, partnerships, and commingled funds. US equity strategies include large-, mid-, and small-cap public equities. One investment in this category currently may not be redeemed in the first three years, and one may be only partially redeemed during the next five years. International equities include developed market (ex–US public equities) and emerging market strategies. One investment in this category currently may not be redeemed in the first three years, and several may be only partially redeemed during the next three to five years.

Fixed income strategies include US government securities, agency securities, inflation-linked bonds (TIPS), corporate bonds, global bonds, and short-term cash investments. As of August 31, 2013, one investment in this category may be only partially redeemed over the next three years.

The high-yield credit portfolio includes investments in distressed debt and other credit instruments with fixed income characteristics but more specific risk tied to the securities and their underlying cash flows.

The absolute return portfolio is weighted toward long-short equity managers, uncorrelated strategies, and diversifying event-driven or hedged credit strategies. Two investments in this portfolio currently may not be redeemed in the first two years. The remaining restriction periods for these funds ranged from approximately one month to five years as of August 31, 2013.

The private investments portfolio includes investments in global buyout and venture capital funds. The real assets portfolio includes the University's investments in energy, timber, real estate, and public investments in some commodity funds.

Management's estimate of the lives of the funds could vary significantly depending on the investment decisions of the external fund managers, changes in the University's portfolio, and other circumstances. Furthermore, the University's obligation to fund these commitments may be waived by the fund managers for a variety of reasons, including the market environment and/or changes in investment strategy.

Investment Return

The components of total investment return were as follows:

(in thousands of dollars)	*August 31, 2013*	*August 31, 2012*
Investment income	$81,893	$39,197
Net realized gains	408,480	318,786
Change in net unrealized gains	328,451	40,319
Total investment return	**$818,824**	**$398,302**

Investment return designated for operations is defined as the investment payout, according to the spending guideline for the Long-Term Balanced Pool and the actual investment income for all other investments. Investment income from specific investments held at cost totaled $18.1 million and $15.1 million at August 31, 2013, and 2012, respectively. All other investment returns are categorized as nonoperating. As reflected in the consolidated statements of activities, investment return was as follows:

(in thousands of dollars)	*August 31, 2013*	*August 31, 2012*
Changes in unrestricted net assets		
Operating: investment return	$264,988	$234,373
Nonoperating: investment returns, reduced by operating distribution	269,290	56,326
Changes in temporarily restricted net assets		
Operating: investment return	124,999	116,992
Nonoperating: investment returns, reduced by operating distribution	159,547	(9,389)
Total investment return	**$818,824**	**$398,302**

Certain expenses paid directly by the University for investment management and custody services totaled $39 million and $41 million as of August 31, 2013, and 2012, respectively, and have been netted against investment earnings.

Derivative Financial Instruments

The University has entered into hedging transactions via various interest-rate swaps and options and has maintained those positions since fiscal year 2010. The fair value of derivatives was $2.3 million as of August 31, 2013, and was in a liability position of $9.5 million as of August 31, 2012. These swaps and options had a notional value of $400 million at August 31, 2013, and 2012. These instruments are held in the fixed income asset class in the summary of changes in investments within Level 3.

Credit exposure represents the University's potential loss if all the counterparties fail to perform under the terms of the contracts, and if all collateral, if any, becomes worthless. This exposure is measured by the fair value of the cash collateral held at the counterparties at the reporting date. The University manages its exposure to credit risk by using highly rated counterparties, establishing risk-control limits, and obtaining collateral where appropriate. As a result, the University has limited credit risk. The University has entered into margin collateral agreements with major investment banks that impose a $1 million threshold on both parties. As of August 31, 2013, the University held collateral of $2.9 million from one counterparty. To date, the University has not incurred any losses on derivative financial instruments due to counterparty nonperformance.

The University has hired an external manager to use derivative financial instruments to obtain market exposure in equity and fixed income indices on excess cash balances. As of August 31, 2013, and 2012, the outstanding notional value of these derivatives was $162 million and $108 million, respectively. They had realized gains for fiscal year 2013 of $21.9 million and for fiscal year 2012 of $1.7 million.

The University regularly reviews the use of derivative financial instruments by each of the managers of alternative investment funds in which it participates. While these outside managers generally use such instruments for hedging purposes, derivative financial instruments are employed for trading purposes by numerous independent asset managers of the University.

5. Land, Buildings, and Equipment

Land, buildings, and equipment consisted of the following:

(in thousands of dollars)	*August 31, 2013*	*August 31, 2012*
Land	$28,389	$28,389
Construction in progress	305,201	183,350
Buildings and leasehold improvements	2,124,087	2,058,724
Equipment	479,984	468,494
Accumulated depreciation	(1,254,022)	(1,162,932)
Total land, buildings, and equipment	**$1,683,639**	**$1,576,025**

The estimated cost to complete construction in progress at August 31, 2013, was $418.5 million. Costs included in construction in progress are building and leasehold improvement capitalizations. Building costs are funded by loans, gifts (received or pledged), grants, and unrestricted funds.

Under the University's interest capitalization policy, actual 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 capitalized cost is reflected in the total cost of the asset and depreciated over the useful life of the asset. Assets may include buildings and major equipment.

Asset Retirement Obligations

Asset retirement obligations were adjusted during fiscal years 2013 and 2012 as follows:

(in thousands of dollars)	*August 31, 2013*	*August 31, 2012*
Balance at beginning of year	$129,842	$121,091
(Reduction) increase in retirement asset obligations	(3,974)	2,859
Accretion expense	6,189	5,892
Balance at end of year	**$132,057**	**$129,842**

Lease Obligations

The University is obligated under numerous operating leases to pay base rent through the lease expiration dates. Operating leases consist primarily of leases for the use of real property and have terms expiring in various years through fiscal year 2025. Noncancelable real estate lease expenses totaled $12.9 million at August 31, 2013. In fiscal year 2012 real estate lease expenses were $12.1 million at August 31. The future minimum lease payments under noncancelable operating leases through August 31 of each period are as shown at right.

(in thousands of dollars)	
2014	$14,167
2015	14,215
2016	14,357
2017	13,805
2018	13,983
2019 and thereafter	55,354
Total	**$125,881**

6. Other Assets

Other assets are summarized on the consolidated statements of financial position as follows:

(in thousands of dollars)	*August 31, 2013*	*August 31, 2012*
Prepaid bond expenses	$6,612	$6,899
Inventories	2,697	1,998
Other assets	9,310	7,648
Total other assets	**$18,619**	**$16,545**

7. Deposits Payable and Actuarial Liability of Annuities Payable

Deposits payable and actuarial liability of annuities payable are summarized on the consolidated statements of financial position as follows:

(in thousands of dollars)	*August 31, 2013*	*August 31, 2012*
Agency deposits payable	$123,993	$66,995
Actuarial liability of annuities payable	17,588	17,623
Student loan deposits payable	20,147	23,436
Other deposits payable	4,045	5,004
Total deposits payable and actuarial liability of annuities payable	**$165,773**	**$113,058**

8. Bonds, Notes, and Other Debt Payable

Bonds and notes payable are as follows:

(in thousands of dollars)	*August 31, 2013*	*August 31, 2012*
IEFA–Series 1993	$3,550	$6,815
Less unamortized discount on IEFA–Series 1993	(73)	(146)
IEFA–Series 2003	185,010	185,010
IFA–Series 2004	135,800	135,800
IFA–Series 2006	145,130	145,130
Plus unaccreted premium on IFA–Series 2006	4,549	4,701
IFA–Series 2008	125,000	125,000
Taxable–Series 2012	200,000	200,000
Bonds payable subtotal	**798,966**	**802,310**
Notes payable–commercial paper, taxable	150,000	170,000
Total bonds and notes payable	**$948,966**	**$972,310**

Debt issuance	**Interest-rate mode**	**Interest rate**	**Maturity**
IEFA–Series 1993	Fixed	5.5%	December 1, 2013
IEFA–Series 2003	Fixed	5% [a]	December 1, 2014, to December 1, 2038
IFA–Series 2004	Variable	1.75% [b]	December 1, 2034
IFA–Series 2006	Fixed	5% [a]	December 1, 2042
IFA–Series 2008	Variable	.05% and .37% [c]	December 1, 2046
Taxable–Series 2012	Fixed	4.2%	December 1, 2039, to December 1, 2047
Notes payable–commercial paper, taxable	Fixed	.16% [a]	September 6, 2013, to October 18, 2013

(a) Weighted average interest rate at August 31, 2013
(b) $135.8 million, with interest rate reset at March 3, 2014
(c) $50 million, with interest rate reset weekly; $75 million, with interest rate reset at March 3, 2014

Total obligations, including bonds and notes payable at August 31, 2013, are scheduled to mature through August 31 of each period as noted below. The schedule has been prepared based on the contractual maturities of the debt outstanding at August 31, 2013. Accordingly, if remarketing of bonds fails in future periods, debt repayments may become more accelerated than presented here. The potential failed remarketings coincide with the interest-rate reset dates and amounts noted above.

(in thousands of dollars)	
2014	$153,550
2015	3,470
2016	3,700
2017	4,040
2018	4,255
Thereafter	775,475
Total	**$944,490**

Bonds Payable

The Taxable–Series 2012 Fixed Rate Revenue Bonds were issued to pay the cost of acquiring, constructing, and equipping certain educational facilities of the University and to pay certain costs relating to the issuance of the bonds, subject to conditions set forth in a trust indenture between the University and Wells Fargo Bank, National Association.

The IFA–Series 2008 Adjustable Rate Revenue Bonds were issued to acquire, construct, renovate, remodel, improve, and equip capital projects, subject to conditions set forth in a trust indenture and loan agreement between the University and the Illinois Finance Authority. The bonds may operate in a daily, weekly, adjustable, or auction-rate mode.

The IFA–Series 2006 Revenue Bonds were issued to refund the University's outstanding IEFA–Series 1997 Adjustable Medium-Term Revenue Bonds totaling $145 million. The refunding bonds are subject to conditions set forth in a trust indenture and loan agreement between the University and the Illinois Finance Authority.

The IFA–Series 2004 Adjustable Rate Revenue Bonds were issued to acquire, construct, renovate, remodel, improve, and equip capital projects on both the Evanston and the Chicago campuses, subject to conditions set forth in a trust indenture and loan agreement between the University and the Illinois Finance Authority. The bonds may operate in a daily, weekly, adjustable, or auction-rate mode.

The IEFA–Series 2003 Fixed Rate Revenue Bonds were issued to acquire, construct, or renovate certain University facilities and to refund $35 million of the University's outstanding IEFA–Series 1993 bonds, subject to conditions set forth in a trust indenture and loan agreement between the University and the Illinois Educational Facilities Authority.

The IEFA–Series 1993 Revenue Refunding Bonds operate in a fixed mode until maturity, currently bearing interest at a fixed rate of 5.5 percent. Proceeds of the refunding bonds were invested in United States government securities with a cost of $75.4 million and placed in escrow to satisfy scheduled payments of $66.4 million of the IEFA–Series 1985 bonds and related interest until maturity.

Based on Level 2 observable inputs, at August 31, 2013, the fair value of the University's fixed-rate debt of $541.6 million exceeded the carrying value of $533.7 million by $7.9 million. At August 31, 2012, the fair value of the University's fixed-rate debt of $582.7 million exceeded the carrying value of $537 million by $45.7 million.

Derivative Financial Instruments

The University has entered into interest-rate swap agreements to hedge variable-rate exposure related to its variable-rate debt. The agreements effectively fix the interest rates at a range of 4.2 to 4.38 percent. The notional value is $262.1 million through August 29, 2014, and reduces to $125 million effective August 30, 2014, through expiration on December 1, 2046.

The University recognized a net unrealized gain on the swap investment totaling $40.3 million for the fiscal year ended August 31, 2013, and a net unrealized loss of $20 million for the fiscal year ended August 31, 2012. The fair values of the swap position were in liability positions of $30.8 million and $71.1 million as of August 31, 2013, and 2012, respectively, and are included in accounts payable and accrued expenses on the consolidated statements of financial position.

Notes Payable

The University places commercial paper under a $300 million Taxable Commercial Paper Note.

Other Debt Payable

At August 31, 2013, the University held or had the ability to draw $300 million in standby lines of credit to supplement working capital requirements as follows:

(in thousands of dollars)

Expiration Date	Available credit
December 13, 2013[a]	$25,000
April 1, 2014	75,000
May 13, 2014	25,000
June 14, 2014	50,000
July 26, 2014	75,000
August 20, 2014	50,000
Total	**$300,000**

[a] *Renewed on December 13, 2013, through December 12, 2014.*

9. Endowments

The FASB ASC Not-for-Profit Entities Presentation of Financial Statements Subtopic provides guidance on the net asset classification of donor-restricted endowment funds for not-for-profit organizations subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and improves disclosure about an organization's endowment funds, both donor-restricted and board-designated, regardless of whether the organization is subject to UPMIFA.

The University interprets UPMIFA as requiring that the fair value of the original donor-restricted endowment gift be preserved as of the gift date unless there are explicit donor stipulations to the contrary. Therefore, the University classifies as permanently restricted net assets the original value of gifts donated to the permanent endowment, the original value of subsequent gifts, and accumulations to the permanent endowment made in accordance with the applicable donor gift instrument at the time the accumulation was added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until it is appropriated for University expenditure in a manner consistent with UPMIFA's standard of prudence. In accordance with UPMIFA, the University considers the following factors in determining to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the endowment fund
- The purposes of the institution and of the endowment fund
- General economic conditions
- The possible effects of inflation or deflation
- The expected total return from income and appreciation of investments
- Other resources of the institution
- The institutional investment policy

The University's endowment consists of about 2,200 individual donor-restricted endowment funds and about 900 funds it designates to function as endowments. The net assets associated with endowment funds, including funds designated by the University to function as endowments, are classified and reported based on whether there are donor-imposed restrictions. Institution-designated endowment funds include quasi-endowments established by specific Board of Trustees approval as well as endowments created by management under general guidelines and policies approved by the Board of Trustees.

The following tables present the endowment net asset composition by type of fund at fair value for the years ended August 31, 2013, and 2012:

(in thousands of dollars) *August 31, 2013*

Endowment net asset composition by type of fund	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	($2,013)	$2,026,346	$1,108,485	$3,132,818
Institution-designated endowment funds	3,150,312			3,150,312
Total endowment funds	**$3,148,299**	**$2,026,346**	**$1,108,485**	**$6,283,130**

(in thousands of dollars) *August 31, 2012*

Endowment net asset composition by type of fund	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	($4,527)	$1,870,885	$1,055,210	$2,921,568
Institution-designated endowment funds	2,652,751			2,652,751
Total endowment funds	**$2,648,224**	**$1,870,885**	**$1,055,210**	**$5,574,319**

Investment and Spending Policies

The University's endowment is primarily invested in the Long-Term Balanced Pool, which is managed with the objective of long-term total return. The Investments Committee of the Board of Trustees annually reviews asset allocation policy for the pool.

The principal objective for the Long-Term Balanced Pool is to preserve purchasing power and to provide a growing stream of income to fund University programs. On average, the pool seeks to achieve an annual total rate of return (i.e., actual income plus appreciation) equal to inflation plus actual spending. This objective of preserving purchasing power emphasizes the need for a long-term perspective in formulating both spending and investment policies.

The Board of Trustees has adopted a guideline for the annual spending rate from the University's Long-Term Balanced Pool. The calculation blends market and spending elements for the total annual spending rate.

The market element is an amount equal to 4.35 percent of the market value of a unit in the pool, averaged for the 12 months ended October 31 of the prior fiscal year. It is weighted at 30 percent in determining the total. The spending element is an amount equal to the current fiscal year's spending amount increased by 1.5 percent plus the actual rate of inflation. It is weighted at 70 percent in determining the total.

If investment income received is not sufficient to support the total-return objective, the balance is provided from realized and unrealized gains. If the income received is in excess of the objective, the balance is reinvested in the Long-Term Balanced Pool on behalf of the unit holders.

The University's policy is to allocate the current income of all other investment pools.

Changes In Endowment Net Assets

The following tables represent the changes in endowment net assets for the years ended August 31, 2013, and 2012:

(in thousands of dollars)				*August 31, 2013*
	Unrestricted	**Temporarily restricted**	**Permanently restricted**	**Total**
Endowment net assets, beginning of year	$2,648,224	$1,870,885	$1,055,210	$5,574,319
Investment loss	(23,632)	(21,859)		(45,491)
Net appreciation (realized and unrealized)	335,161	305,179		640,340
Total investment return	311,529	283,320	—	594,849
Contributions		1,372	40,724	42,096
Appropriation of endowment assets for expenditure	(114,714)	(124,977)	—	(239,691)
Other changes				
Transfers to create institutional funds	336,566	—	—	336,566
Transfers of institutional funds per donor requirement		(83)	15,218	15,135
Spending of institution-designated endowment fund	(40,144)	—	—	(40,144)
Other reclassifications	6,838	(4,171)	(2,667)	—
Endowment net assets, end of year	**$3,148,299**	**$2,026,346**	**$1,108,485**	**$6,283,130**

(in thousands of dollars)				*August 31, 2012*
	Unrestricted	**Temporarily restricted**	**Permanently restricted**	**Total**
Endowment net assets, beginning of year	$2,606,810	$1,884,520	$983,605	$5,474,935
Investment loss	(8,057)	(8,533)		(16,590)
Net appreciation (realized and unrealized)	106,994	113,858		220,852
Total investment return	98,937	105,325	—	204,262
Contributions		260	46,487	46,747
Appropriation of endowment assets for expenditure	(105,833)	(117,159)	—	(222,992)
Other changes				
Transfers to create institutional funds	147,087	—	—	147,087
Transfers of institutional funds per donor requirement		76	16,625	16,701
Spending of institution-designated endowment fund	(92,421)	—	—	(92,421)
Other reclassifications	(6,356)	(2,137)	8,493	—
Endowment net assets, end of year	**$2,648,224**	**$1,870,885**	**$1,055,210**	**$5,574,319**

Underwater Endowment Funds

The University monitors endowment funds to identify those for which historical cost was more than fair value. As of August 31, 2013, and 2012, the historical cost of such accounts was approximately $35 million and $74 million, and the market value totaled $33 million and $69 million, respectively. Associated unrealized losses are recorded in the unrestricted net assets classification; subsequent gains increase unrestricted net assets.

10. Retirement Plans

The University maintains two contributory retirement plans for its eligible faculty and staff. The plans offer employees two investment company options, Teachers Insurance and Annuity Association (TIAA) and College Retirement Equities Fund (CREF), and the mutual funds offered by Fidelity Investments. Participating employee and University contributions are immediately vested. The University contributed $61.3 million and $58.9 million to the two plans in 2013 and 2012, respectively. It expects to contribute $63.7 million to the two plans in 2014.

The University currently sponsors a healthcare plan permitting retirees to continue participation on a "pay-all" basis; it has no liability for participants past age 65. The retiree contribution is based on the average per-capita cost of coverage for the plan's entire group of active employees and retirees rather than the per-capita cost for retirees only. Retirees are also eligible to participate in certain tuition reimbursement plans and may receive a payment for sick days accumulated at retirement. The accrued cost for postemployment benefits was $14.1 million and $14.2 million at August 31, 2013, and 2012, respectively, and is included in accounts payable and accrued expenses on the consolidated statements of financial position.

The University recognizes an asset or a liability in the statements of financial position for the plans' overfunded or underfunded status. The asset or liability is the difference between the fair value of plan assets and the related benefit obligation, defined as the projected benefit obligation for postemployment benefit programs and the accumulated postretirement benefit obligation (APBO) for postretirement benefit programs, such as a retiree healthcare plan. In the consolidated statements of activities, the University recognizes actuarial gains or losses and prior service costs or credits that arise during the period but are not components of net periodic benefit cost. The University measures plan assets and obligations as of the date of its fiscal year-end and makes specified disclosures for the upcoming fiscal year.

The University funds the benefit costs as they are incurred. The following table sets forth the plan's obligations, benefits paid, contributions, net periodic postretirement benefit cost, and assets:

(in thousands of dollars)	*August 31, 2013*	*August 31, 2012*
Benefit obligations	$14,390	$15,510
Benefits paid	780	825
Employer contributions	230	336
Contributions from participants	549	489
Net periodic postretirement benefit cost	1,550	1,660
Fair value of plan assets	—	—

The accumulated other comprehensive income included in unrestricted net assets on the consolidated statements of financial position totaled net losses of $1.3 million and $3.8 million as of August 31, 2013, and 2012 respectively; a decrease of $2.4 million due to net gains during fiscal year 2013.

The APBO was $14.4 million and $15.5 million at August 31, 2013, and 2012, respectively, and is included in accounts payable and accrued expenses on the consolidated statements of financial position.

The following tables present key actuarial assumptions used in determining APBO as of August 31, 2013, and 2012. For both fiscal years 2013 and 2012, the ultimate healthcare cost trend rate was 5 percent, and the year when trend rate will reach the ultimate trend rate was 2023.

Additional assumptions used to determine benefit obligations were as follows:

	August 31, 2013	*August 31, 2012*
Settlement (discount) rate	4.3%	3.2%
Weighted average rate of increase in future compensation levels	3%	3%
Healthcare cost trend rate	7.5%	7.75%

Next, the assumptions used to determine net periodic benefit cost:

	August 31, 2013	*August 31, 2012*
Discount rate	3.2%	4.5%
Weighted average rate of increase in future compensation levels	3%	4%
Healthcare cost trend rate	7.75%	8%

A one-percentage-point change in assumed healthcare cost trend rates would have had these effects in fiscal year 2013:

(in thousands of dollars)	*1% point decrease*	*1% point increase*
(Decrease) increase in total of service and interest cost	($107)	$124
(Decrease) increase in postretirement benefit obligation	(698)	782

Estimated future benefit payments reflecting anticipated service, as appropriate, are expected to be paid as shown below.

(in thousands of dollars)	
2014	$588
2015	573
2016	691
2017	775
2018	888
2019–2023	5,992
Total	**$9,507**

The University offers a deferred compensation plan under Internal Revenue Code 457(b) to a select group of management and highly compensated employees. There is no University contribution related to this deferred compensation plan. The University has recorded both an asset and a liability related to the deferred compensation plan that totaled $43 million and $35.3 million in fiscal years 2013 and 2012, respectively; these are included in investments and deposits payable and actuarial liability of annuities payable on the consolidated statements of financial position.

11. Related Parties

Members of the University's Board of Trustees, senior management, and faculty may on occasion be associated either directly or indirectly with entities doing business with the University. The University bylaws and conflict of interest policies establish guidelines for disclosure and regulation of such activities as circumstances warrant. When such associations exist, measures are taken, in the best interests of the University, to mitigate any actual or perceived conflict. Transactions with related parties may include investment management, common membership in investment partnerships or other investment vehicles, and the purchase of goods or services.

Northwestern Medical Faculty Foundation (NMFF), a related party, is a multispecialty physician organization committed to providing clinical care to patients and to supporting the research and academic endeavors of Northwestern's Feinberg School of Medicine (Feinberg). An independent not-for-profit organization, NMFF is governed by a board of directors. NMFF physicians are full-time faculty members or researchers at Feinberg. Accounts receivable from NMFF arise out of operational activities. Such receivables totaled

$10.1 million and $9.7 million as of August 31, 2013, and 2012, respectively, and are included in accounts receivable on the consolidated statements of financial position. In addition, under the terms of an agreement with the University, NMFF contributes a percentage of its revenue to a research and education fund, medical education programs, basic and applied biomedical research facilities and programs, and research and educational support services. NMFF also contributes funds to Feinberg's teaching and research activities on a discretionary basis. These contributions totaled $60.8 million in fiscal year 2013 and $47.1 million in fiscal year 2012 and are included in private gifts on the consolidated statements of activities.

12. Self-Insurance Reserves and Other Contingencies

Reserves for losses under the University's self-insurance program, aggregating $10.3 million and $11.6 million at August 31, 2013, and 2012, respectively, include reserves for probable known losses and for losses incurred but not yet reported. A portion of the reserves pertaining to professional, general, and automobile liability has been determined on a discounted present-value basis. The discount rate was 7.5 percent in fiscal years 2013 and 2012. Self-insurance reserves are based on estimates of historical loss experience, and while management believes that the reserves are adequate, the ultimate liabilities may be more or less than the amounts provided. These reserves are included in accounts payable and accrued expenses on the consolidated statements of financial position.

Under an agreement between the University and NMFF, a proportionate share of primary medical professional liability costs that arise out of events prior to November 1, 2004, is borne by NMFF. As of November 1, 2004, NMFF obtained excess medical liability coverage through another institution for all events after October 1, 2002, and reported after November 1, 2004.

The University has contracted to service student loans sold to a lending agency prior to fiscal year 2009; these totaled $64.6 million and $84.4 million at August 31, 2013, and 2012, respectively. Service revenues are the excess of the actual interest collected above the agreed-upon warehouse fees on the serviced loans. The University manages the program to break even and generates no servicing assets or liabilities through these activities. The University guarantees these loans against default up to 10 percent of the original domestic loan portfolio and 30 percent of the original international amounts. The maximum future total payments were $7.1 million as of August 31, 2013. At August 31, 2013, and 2012, $204,000 and $256,000, respectively, were reserved in anticipation of future defaults. Notes receivable on the consolidated statements of financial position are shown net of these reserves in fiscal years 2013 and 2012.

In August 2009, the University, as originating lender, began participation in a student loan securitization program. It sold student loans to a school trust totaling $65 million in 2009, $19.8 million in 2010, and $22.5 million in 2012; the University issued University guaranteed notes, which were purchased by a funding trust that procures financing to support the lending program. The programs are managed to break even and generate no servicing assets or liabilities. Guaranteed notes under these programs totaled $63.6 million and $77.2 million as of August 31, 2013, and 2012, respectively. These loans are included in notes receivable and deposits payable on the consolidated statements of financial position. Reserves in anticipation of securitized student loan future defaults totaled $178,000 and $216,000 at August 31, 2013, and 2012, respectively. Notes receivable on the consolidated statements of financial position are shown net of these reserves in fiscal years 2013 and 2012.

From time to time, various claims and suits generally incidental to the conduct of normal business are pending or may arise against the University. It is the opinion of management of the University, after taking into account insurance coverage, that any losses from the resolution of pending litigation should not have a material effect on the University's financial position or results of operations.

All funds expended in connection with government grants and contracts are subject to audit by government agencies. While any ultimate liability from audits of government grants and contracts by government agencies cannot be determined at present, management believes that it should not have a material effect on the University's financial position or results of operations.

13. Grants and Contracts

Grants and contracts are summarized on the consolidated statements of activities as follows:

(in thousands of dollars)	*August 31, 2013*	*August 31, 2012*
Federal grants	$402,984	$406,375
Private grants and contracts	133,933	118,385
State grants	5,930	10,289
Total grants and contracts	**$542,847**	**$535,049**

14. Functional Classification of Expenses

Expenses by functional categories reflect salaries, wages, benefits, goods, and services used for those specific purposes. The University has allocated functional expenses for maintenance of facilities, as well as for depreciation, accretion for asset retirement obligations, and interest on indebtedness, to other functional categories based on the functional use of space on the University's campuses.

Operating expenses incurred in the fiscal years ended August 31, 2013, and 2012, were as follows:

(in thousands of dollars)					*August 31, 2013*
	Maintenance of facilities	**Depreciation and accretion**	**Interest on indebtedness**	**All other operating expenses**	**Total**
Instruction	$21,223	$15,234	$5,392	$613,778	$655,627
Research	39,677	28,480	10,081	352,413	430,651
Academic support	29,835	21,415	7,581	199,954	258,785
Student services	19,839	14,240	5,041	129,211	168,331
Institutional support	7,228	5,188	1,837	266,105	280,358
Auxiliary services	35,986	25,832	9,144	34,587	105,549
Total	**$153,788**	**$110,389**	**$39,076**	**$1,596,048**	**$1,899,301**

(in thousands of dollars)					*August 31, 2012*
	Maintenance of facilities	**Depreciation and accretion**	**Interest on indebtedness**	**All other operating expenses**	**Total**
Instruction	$19,119	$14,938	$4,653	$592,454	$631,164
Research	35,957	28,090	8,751	352,945	425,743
Academic support	27,680	21,626	6,736	159,617	215,659
Student services	18,834	14,715	4,583	118,177	156,309
Institutional support	6,991	5,463	1,701	245,900	260,055
Auxiliary services	34,101	26,642	8,299	33,479	102,521
Total	**$142,682**	**$111,474**	**$34,723**	**$1,502,572**	**$1,791,451**

15. Subsequent Events

The University has evaluated subsequent events in accordance with the FASB ASC Subsequent Event Topic through January 13, 2014, the date when the consolidated financial statements were issued. The following events were identified:

Related party NMFF entered into an agreement with and became a wholly owned subsidiary of Northwestern Memorial Healthcare Corporation (NMHC) as of September 1, 2013. NMFF retains its corporate form as a not-for-profit organization, and its primary mission remains the same. Under terms of agreements between the University, NMFF, and NMHC, the University will continue to receive contributions to support the Feinberg School's research and education programs. Through January 10, 2014, one-time transfers totaling $170.1 million have been made from NMFF to the University as a part of the agreement.

On October 10, 2013, the University executed amendments to three of its interest-rate swap agreements with a total notional value of $125 million, shortening their maturity date from December 1, 2046, to August 31, 2023. The University received payments totaling $590,000 in two of the amendments; under the third amendment, the remaining fixed-payment portion of the swap was reduced from 4.325 percent to 4.123 percent.

On October 21, 2013, the University issued $586 million in taxable bonds with an average interest rate of 4.63 percent. Proceeds of this issuance were used to refinance the University's Illinois Educational Facilities Authority–Series 2003 fixed-rate bonds, totaling $185 million on December 1, 2013, with the remainder being used to finance future capital construction.

On October 31, 2013, the University purchased a $61 million portfolio of private education loans from a lending agency; these loans had been purchased by the lending agency from the University before 2009 and will continue to be serviced by the University.

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