Northwestern

2017 FINANCIAL REPORT

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Report of the Executive Vice President

To the Board of Trustees of Northwestern University:

The *2017 Financial Report* highlights the University's financial health and capacity.

At over $10 billion in 2017, our endowment remains a key driver of Northwestern's financial strength. The investment portfolio continues to meet long-term objectives despite fluctuations in the world economy and financial markets. Total assets grew to $14.5 billion, an increase of $836 million from the prior year, with net assets increasing to $11.7 billion. The Consolidated Statements of Financial Position show results consistent with the University's AAA credit rating, attesting to Northwestern's robust capacity to advance its priorities.

This strong financial position enables the University to enhance its distinction among the best global universities. Ambitious strategic plans are guiding programmatic and capital investments in undergraduate and graduate student aid, faculty recruitment and retention, and global strategy developments. Highly visible outcomes of the University's capital plan in 2017 include a new residence hall at 560 Lincoln Street, the renovated Seeley G. Mudd Library, and the new Kellogg Global Hub. In the coming year, we will see completion of the Ryan Fieldhouse and Walter Athletics Center, as well as completion of extensive renovations to Welsh-Ryan Arena. On the Chicago campus, the University continues construction on the Louis A. Simpson and Kimberly K. Querrey Biomedical Research Center, which will be the catalyst for expanded biomedical research.

While Northwestern closed fiscal year 2017 with positive operating results, considerable pressures on higher education resources emphasize the importance of striking the right balance between programmatic and financial risks and opportunities. Generous support from University alumni and friends enables our continued programmatic investments and builds our foundation for excellence in teaching and research. The University surpassed $3.5 billion in new gifts and commitments as part of **We Will. The Campaign for Northwestern.**

With the ongoing commitment of the exceptional Northwestern community of faculty, students, and staff, I am confident we will continue to build on our successes and maintain our momentum in support of ambitious strategic plans.

Nim Chinniah
Executive Vice President

Investment Report

After enduring a tepid fiscal year 2016, the University's endowment rebounded as worldwide equity markets soared following the US presidential election. US large-capitalization equities moved significantly higher, as the S&P 500 posted a gain of 16 percent. International equities were even stronger during the fiscal year. Emerging markets led the way, rallying 25 percent, while developed economy markets increased 18 percent.

The University's diversified portfolio posted an 11.7 percent gain for the fiscal year ended August 31, 2017. The Long-Term Balanced Pool increased in total value by $652 million to $10.5 billion, as investment gains ($1,070 million) more than doubled the amount of spending ($506 million). On August 31, 2017, the University's investment assets, including cash and separately invested University holdings, totaled $10.8 billion.

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 and bond-like investments with a one- to two-year horizon, for funding planned capital expenditures; 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, 2017					
	2013	*2014*	*2015*	*2016*	*2017*
Long-Term Balanced Pool					
Net asset value *(in thousands of dollars)*	$7,850,651	$9,704,003	$9,867,262	$9,803,725	$10,456,022
Number of units *(in thousands)*	36,390	40,169	41,601	42,577	43,212
Net asset value per unit	$215.74	$241.58	$237.19	$230.26	$241.97
Payout amount per unit					
Current earned income	$0.11	($0.08)	($1.21)	($1.13)	($1.07)
Previously reinvested realized gains withdrawn	$8.63	$9.01	$10.44	$10.84	$11.08
Total payout per unit	$8.74	$8.93	$9.23	$9.71	$10.01
Summary of net asset value *(in thousands of dollars)*					
Treasury pool funds	$157,003	$169,951	$609,600	$452,866	$174,503
Separately invested funds	136,625	158,383	150,851	138,118	155,403
Total net asset value *(in thousands of dollars)*	**$8,144,279**	**$10,032,337**	**$10,627,713**	**$10,394,709**	**$10,785,928**

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. At the beginning of fiscal year 2017, the committee ratified the Investment Office's recommendations of a 1 percent increase to each of the US equity and international equity targets, and a corresponding 3 percent increase in private investments. These increases were offset by 4 and 1 percent decreases to the fixed income and absolute return targets, respectively. Subjective considerations such as liquidity and inflation/deflation protection were also part of the analysis.

The next table, which incorporates these changes, 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. The Investment Office recently reviewed the asset allocation mix for fiscal year 2018 with the Investment Committee and reaffirmed existing targets and ranges.

Policy Portfolio Targets and Ranges

	Range	*Target*	*August 31, 2017*	*Difference*
US equity	10–16%	13%	13.1%	0.1%
International equity	14–20%	17%	18.7%	1.7%
Fixed income	5–11%	8%	8.5%	0.5%
High-yield credit	0–10%	5%	3.2%	-1.8%
Absolute return	15–23%	19%	19.1%	0.1%
Private investments	18–26%	22%	21%	-1%
Real assets	12–20%	16%	15.1%	-0.9%
Cash		0%	1.3%	1.3%

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 8 of this report.

The University's investments historically have grown at a rate exceeding the objective. For the 12 months ended August 31, 2017, the portfolio increased 11.7 percent, outperforming the objective by 4.2 percent. Over longer time horizons, the portfolio outperformed the objective by 2.6 percent and 2.2 percent for the 5-year and 15-year periods, respectively, as shown in the table below.

Annualized Returns: Exceeding the Objective

	1-year	3-year	5-year	10-year	15-year
*Annual total return**	11.7%	5.3%	8.7%	5.6%	9%
– Spending	4.9%	4.2%	4.1%	4.1%	4.1%
– University management fee and support	0.7%	0.7%	0.7%	0.7%	0.6%
– Inflation	1.9%	1.1%	1.3%	1.7%	2.1%
= Above or below objective	4.2%	-0.7%	2.6%	-0.9%	2.2%

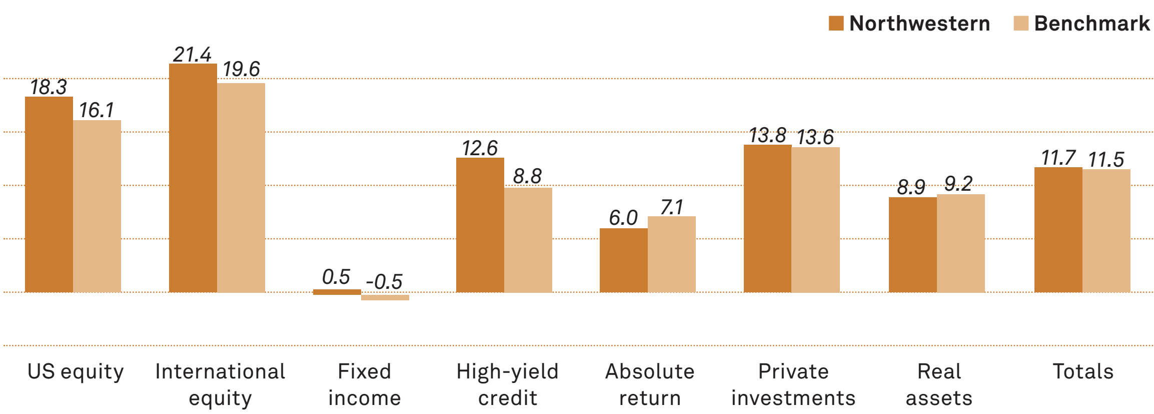
** Total returns are net of fees and are calculated on annual changes in net asset value. They may differ from payout distributions.*

Secondary Investment Performance Objective: Benchmark Comparisons

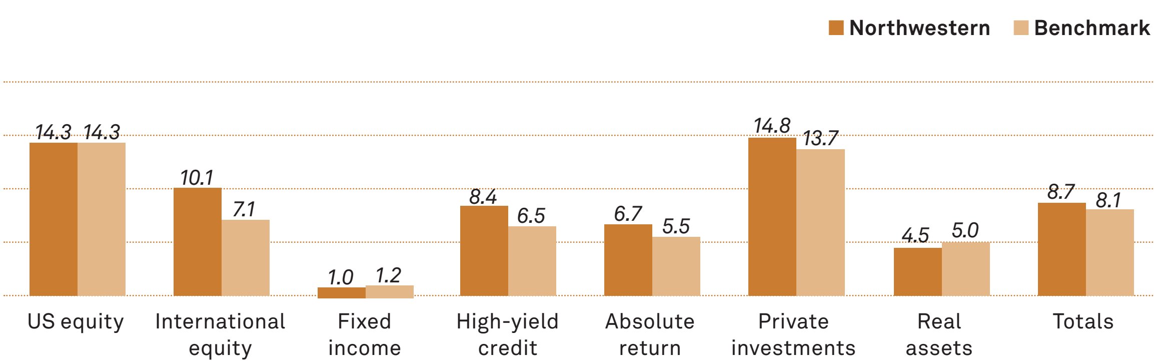
The pool's 11.7 percent return for the 12-month period outperformed the 11.5 percent return of the composite benchmark, a blend of the benchmark returns for each asset class weighted by the policy allocation targets. Outperformance was primarily due to good security selection by managers in rising global equity markets. During this strong-performing fiscal year, five of seven portfolios outpaced their benchmarks, and all of the asset classes posted positive returns on an absolute basis. In particular, both the US equity and international equity portfolios substantially outperformed on a relative basis by 2.2 and 1.8 percent, respectively, versus their benchmarks. International equity was the best performer on an absolute basis, up 21.4 percent. High-yield credit was the top performer on a relative basis (12.6 percent versus 8.8 percent), while absolute return and real assets underperformed their benchmarks by 1.1 percent and 0.3 percent, respectively. The first bar chart below shows returns and benchmarks for all asset classes for the fiscal year.

For the five-year period ended August 31, 2017, the Long-Term Balanced Pool outperformed the composite benchmark (8.7 percent versus 8.1 percent), as shown in the second bar chart below. Four of the seven portfolios exceeded their benchmarks over five years, while only fixed income and real assets underperformed on both an absolute and relative basis. Three of the asset classes were double-digit performers, reflecting the strength in global equity markets, particularly in the United States. A more detailed explanation of activity and performance follows the five-year performance bar chart.

Long-Term Balanced Pool: Fiscal 2017 Net Performance Relative to Benchmarks *(in percentages)*



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



Marketable Securities Categories

US equity was the second-best-performing asset class in both absolute and relative terms during the fiscal year, gaining 18.3 percent and outpacing the 16.1 percent gain of its Russell 3000 benchmark primarily due to manager selection. Over five years, the portfolio has performed in line with its benchmark, as both posted 14.3 percent gains. On a longer-term basis, it has outperformed in 11 of the last 16 fiscal years. In addition, on an absolute basis, US equity was the second-best-performing asset class over the five-year period.

The international equity portfolio gained 21.4 percent for the fiscal year and, in absolute terms, was the best-performing asset class. For the last five years, this portfolio was the best-performing asset class on a relative basis, returning 10.1 percent versus the 7.1 percent return of its benchmark (67 percent MSCI EAFE Index; 33 percent MSCI EM Index). A heavier weight to smaller-capitalization foreign stocks, as well as outstanding manager selection, has helped this portfolio over the five-year period, outperforming in 13 of the last 16 fiscal years.

The fixed income portfolio posted the worst return of all asset classes during the fiscal year. Nonetheless, this portfolio outperformed on a relative basis, returning 0.5 percent versus -0.5 percent for its benchmark. For the last five years, fixed income slightly underperformed on a relative basis, returning 1 percent versus 1.2 percent for its benchmark. It has outperformed in 9 of the last 16 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 tactical 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. Increasing 12.6 percent, this portfolio was the top performer on a relative basis during the fiscal year, ahead of the 8.8 percent gain posted by the benchmark Merrill Lynch High-Yield Master II Index. The high-yield credit portfolio returned 8.4 percent versus 6.5 percent for the benchmark for the five-year period and was the second-best performer on a relative basis for this period. The portfolio was cash flow positive (total distributions less new investments or capital calls), as distributions were $74.4 million and capital calls $33.6 million, for a net cash flow of $40.8 million.

Absolute Return Category

Comprising a diversified selection of hedge fund strategies, this portfolio aims to provide equity-like returns with low correlation to the equity markets. For the fiscal year, it gained 6 percent, below the 7.1 percent return of its benchmark (80 percent Treasury bills plus 400 basis points; 20 percent MSCI All-Country World Index). The portfolio's return of 6.7 percent for the five-year period was positive on an absolute basis and exceeded its benchmark, which was up 5.5 percent. Northwestern's absolute return portfolio is diversified among long-short equity managers (30 percent) and uncorrelated, event-driven, and other hedge fund strategies. These remaining hedge funds (70 percent) tend to be less sensitive to movements in the equity markets and represent diversifying strategies.

Private Investments Category

The private investments portfolio includes investments in global buyout, growth equity, and venture capital funds. This portfolio posted an absolute return of 13.8 percent for the fiscal year and was the best absolute performer for the five-year period, gaining 14.8 percent annualized. On a relative basis, it outperformed the Burgiss Private Investments benchmark return of 13.7 percent for the five-year period. Increased profitability at underlying portfolio companies and merger and acquisition activity significantly bolstered returns in both the fiscal year and the five-year period.

Cash flows in the private investments category were strong for the current fiscal year, as the portfolio was cash-flow positive for the sixth consecutive year since the global financial crisis. The portfolio experienced an increase in capital calls for investments in underlying companies and a slight decrease in trade sales, recapitalizations, and public offerings, resulting in slightly less distributions from the portfolio companies than in the prior fiscal year. For fiscal year 2017, private investment distributions were $344.1 million and capital calls $289.1 million, for a net cash flow of $55 million.

Real Assets Category

The real assets portfolio includes the University's investments in energy, timber, real estate, and publicly traded investments in commodity and energy equity funds. This portfolio underperformed its benchmark return (a mix of energy, real estate, and commodities) on a relative basis in fiscal year 2017, gaining 8.9 percent versus a 9.2 percent gain. For the five-year period, the portfolio gained 4.5 percent as returns reflected the impact of retreating global commodity prices. Distribution activity significantly increased from the prior fiscal year, as there were higher realizations in private partnership real estate and energy investments. With distributions of $355.2 million and capital calls of $338.7 million, the net cash flow was $16.5 million for fiscal year 2017.

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 weighting of 70 percent.

The spending rate for fiscal year 2017 was 4.9 percent. The amount per unit for fiscal year 2018, calculated using the guideline above, is $10.15.

Payout Determined by Spending Guideline

	2013	*2014*	*2015*	*2016*	*2017*
Spending per unit	$8.74	$8.93	$9.23	$9.71	$10.01
Net asset value per unit	$215.74	$241.58	$237.19	$230.26	$241.97
Annual spending rate*	4.08%	3.83%	3.78%	4.07%	4.85%
Total *(in millions)*	$313.17	$350.02	$378.74	$409.44	$505.52
Growth in total spending	8.62%	11.77%	8.21%	8.11%	23.47%

** 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. A special payout for fiscal year 2017 is included.*

The Long-Term Balanced Pool: In Conclusion

Northwestern's portfolio rose the most since 2014 during the fiscal year, as a significant increase in global markets combined with historically low volatility led to outsized gains. Unlike last fiscal year, strong relative performance among our active managers also buoyed the portfolio overall. We continue to believe the Long-Term Balanced Pool is poised to grow and support the University's needs. Its success is based on the diversification and the skill of outstanding money managers worldwide in meeting investment objectives over long time horizons. Despite concerns that returns will be lower over the next decade than in the last 10 years, Northwestern leadership retains its long-term investment focus and is confident in the portfolio's future outlook.

William H. McLean
Vice President and Chief Investment Officer

Independent Auditors' Report

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 statements of financial position as of August 31, 2017, and 2016, the related consolidated statements of activities for the year ended August 31, 2017, and of cash flows for the years ended August 31, 2017, and 2016.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Northwestern University as of August 31, 2017, and 2016, and the changes in its net assets for the year ended August 31, 2017, and its cash flows for the years ended August 31, 2017, and 2016, in accordance with accounting principles generally accepted in the United States of America.

Other Matter

We previously audited the consolidated statement of financial position as of August 31, 2016, and the related consolidated statements of activities (not presented herein) and of cash flows for the year then ended, and in our report dated February 2, 2017, we expressed an unmodified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying summarized financial information as of August 31, 2016, for the year then ended is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

PricewaterhouseCoopers LLP

January 10, 2018

Consolidated Statements of Financial Position

As of August 31, 2017, and August 31, 2016

(in thousands of dollars)	*2017*	*2016*
Assets		
Cash and cash equivalents	$92,623	$215,375
Accounts receivable, *net*	263,424	326,446
Notes receivable, *net*	151,679	156,428
Contributions receivable, *net*	318,780	263,423
Investments	10,717,787	10,312,782
Land, buildings, and equipment, *net*	2,933,679	2,368,598
Other assets	17,973	17,125
Total assets	**$14,495,945**	**$13,660,177**
Liabilities		
Accounts payable and accrued expenses	$295,641	$265,979
Deferred revenue	277,853	289,083
Deposits payable and actuarial liability of annuities payable	156,179	140,836
Government advances for student loans	30,559	37,766
Asset retirement obligations	3,250	2,940
Bonds, notes, and other debt payable	2,049,080	1,909,164
Total liabilities	**$2,812,562**	**$2,645,768**
Net assets		
Unrestricted	$7,338,857	$6,986,925
Temporarily restricted	2,720,408	2,472,172
Permanently restricted	1,624,118	1,555,312
Total net assets	**$11,683,383**	**$11,014,409**
Total liabilities and net assets	**$14,495,945**	**$13,660,177**

See Notes to the Consolidated Financial Statements, beginning on page 14.

Consolidated Statement of Activities

For the fiscal year ended August 31, 2017, and summarized financial information for the fiscal year ended August 31, 2016

(in thousands of dollars)	*2017*				*2016*
Operating revenues	**Unrestricted**	**Temporarily restricted**	**Permanently restricted**	**Total**	**Total**
Tuition and fees	$1,008,586			$1,008,586	$963,001
(less scholarships and fellowships)	(419,944)			(419,944)	(381,713)
Net tuition and fees	588,642			588,642	581,288
Auxiliary services	80,812			80,812	79,036
Grants and contracts	617,448			617,448	595,774
Private gifts	199,630			199,630	200,892
Investment return designated for operations	445,137	$159,397		604,534	509,009
Sales and services	171,289			171,289	161,615
Professional fees	34,929			34,929	31,345
Royalties and trademarks	12,134			12,134	41,236
Other income	576			576	793
Total operating revenues	**2,150,597**	**159,397**		**2,309,994**	**2,200,988**
Net assets released from restrictions	**197,968**	**(197,968)**		**—**	**—**
Total operating revenues and other additions (reductions)	**2,348,565**	**(38,571)**	**—**	**2,309,994**	**2,200,988**
Operating expenses					
Salaries, wages, and benefits	1,343,723			1,343,723	1,242,279
Services, supplies, travel, and other	578,229			578,229	554,631
Depreciation and asset retirement obligation accretion	143,471			143,471	123,225
Operations of plant, rent, and equipment	118,351			118,351	109,283
Utilities and communications	59,687			59,687	55,210
Royalty and trademark fees	9,457			9,457	41,278
Interest on indebtedness	44,378			44,378	40,248
Total operating expenses	**2,297,296**	**—**	**—**	**2,297,296**	**2,166,154**
Excess (deficit) of operating revenues over expenses	**51,269**	**(38,571)**	**—**	**12,698**	**34,834**
Nonoperating revenues and expenses					
Private gifts and grants for buildings and equipment	512			512	1,597
Restricted private gifts		95,118	74,523	169,641	225,034
Net gain (loss) on annuity obligations		1,909	(5,717)	(3,808)	3,338
Investment returns, reduced by operating distribution	293,052	189,780		482,832	(112,488)
Change in value of derivative instruments	7,732			7,732	(1,557)
Other nonoperating net (expenses) revenues	(633)			(633)	70,673
Excess of nonoperating revenues over expenses	**300,663**	**286,807**	**68,806**	**656,276**	**186,597**
Change in net assets	**351,932**	**248,236**	**68,806**	**668,974**	**221,431**
Beginning net assets	**6,986,925**	**2,472,172**	**1,555,312**	**11,014,409**	**10,792,978**
Ending net assets	**$7,338,857**	**$2,720,408**	**$1,624,118**	**$11,683,383**	**$11,014,409**

See Notes to the Consolidated Financial Statements, beginning on page 14.

Consolidated Statements of Cash Flows

For the fiscal years ended August 31, 2017, and August 31, 2016

(in thousands of dollars)	*2017*	*2016*
Cash flows from operating activities		
Change in net assets	$668,974	$221,431
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities		
Depreciation	143,339	117,398
Accretion for asset retirement obligations	132	5,827
Asset retirement obligations added (settled)	178	(2,780)
Change in estimated asset retirement obligations, *net*	—	(71,851)
Net (gains) losses on retirements and sales of buildings and equipment	(362)	6
Net amortization of discounts (and accretion) of premiums on bonds payable	(2,369)	(1,040)
Allowance for student loans receivable	317	667
Net realized and unrealized gains on investments	(1,040,580)	(343,820)
Gift of contributed securities	(51,886)	(49,919)
Proceeds from sale of contributed securities	46,886	49,919
Change in value of derivative instruments	(7,732)	1,557
Private gifts and grants for buildings and equipment	(512)	(1,597)
Changes in assets and liabilities		
Accounts receivable	63,022	(43,520)
Contributions receivable	(55,357)	(94,405)
Other assets	(789)	1,710
Accounts payable and accrued expenses	(3,617)	17,665
Increase in deposits and annuities payable	15,343	17,066
Deferred revenue	(11,230)	18,121
Government advances for student loans	(7,207)	(1,064)
Net cash provided by (used in) operating activities	**(243,450)**	**(158,629)**
Cash flows from investing activities		
Purchases of investments	(1,786,688)	(1,591,765)
Proceeds from sales of investments	2,439,081	2,128,801
Acquisitions of land, buildings, and equipment	(667,350)	(468,756)
Proceeds from sale of buildings or equipment	244	102
Student loans disbursed	(21,345)	(25,385)
Principal collected on student loans	28,113	29,892
Other	(14,154)	(23,076)
Net cash provided by (used in) investing activities	**(22,099)**	**49,813**
Cash flows from financing activities		
Proceeds from issuance of notes, bonds, and other debt payable	232,000	50,000
Principal payments on notes, bonds, and other debt payable	(89,715)	(4,535)
Proceeds from private gifts and grants for buildings and equipment	512	1,597
Net cash provided by (used in) financing activities	**142,797**	**47,062**
(Decrease) increase in cash and cash equivalents	**(122,752)**	**(61,754)**
Cash and cash equivalents at beginning of year	**215,375**	**277,129**
Cash and cash equivalents at end of year	**$92,623**	**$215,375**
Supplemental disclosure of cash flow information		
Accrued liabilities for construction in progress	$60,677	$31,466
Capitalized interest	23,243	24,135
Cash paid for interest	67,663	66,480

See Notes to the Consolidated Financial Statements, beginning on page 14.

Notes to the Consolidated Financial Statements

For the fiscal years ended August 31, 2017, and August 31, 2016

1. Summary of Significant Accounting Policies

University Activities

Northwestern University (Northwestern or the University) is a major private research university with more than 21,000 students enrolled in 12 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 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 may include 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 revenue 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 revenue. 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 notes 4 and 8.

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. In the event that changes in the inputs used in the fair value measurement of an asset or liability result in a transfer of the fair value measurement to a different categorization, such transfers between fair value categories are recognized at the end of the reporting period. The categorization of an investment is based upon its pricing transparency and liquidity and does not necessarily correspond to the University's perceived risk of that investment. As a practical expedient as permitted under GAAP, the reported net asset value (NAV) of investments with external managers is used to estimate their fair value. Investments that use NAV as a practical expedient for valuation purposes are shown separately from the valuation hierarchy. For further discussion, see note 4.

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 that are generally less liquid, are based on valuation information received on the relevant entity and may include last sale information or independent appraisals of value. In addition, standard valuation techniques, including discounted cash flow models or valuation multiples based on comparable investments, may be used. The fair values for these securities are classified as Level 3, reflecting significant unobservable inputs that are supported by little or no market inputs.

Investments in certain real assets and other investments are recorded at acquisition or construction 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, 2017. 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 as, 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, and prepayment rates as well as 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. These inputs to the fair value estimate are classified in Level 3 of the fair value hierarchy. In subsequent periods, the discount rate is unchanged, and the allowance for uncollectible amounts is reassessed and adjusted if necessary. There were no significant conditional promises to give as of August 31, 2017, and August 31, 2016.

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, 2017.

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 notes 10 and 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. ARO 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 ARO 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 2018 fall-quarter tuition and fees, billed but not earned in fiscal year 2017, are reported as deferred revenue in fiscal year 2017. Similarly, fiscal year 2017 fall-quarter tuition and fees, billed but not earned in fiscal year 2016, are reported as deferred revenue in fiscal year 2016.

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. 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 2013 through 2017.

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 are appropriate.

Recent Accounting Pronouncements

In August 2016, the FASB issued Accounting Standards Update (ASU) 2016-14, "Not-for-Profit Entities: Presentation of Financial Statements of Not-for-Profit Entities," the first phase of improvements to financial reporting and presentation. The guidance addresses net asset classifications, and reporting and disclosures about liquidity, financial performance, expenses, and cash flows. The standard is effective in fiscal year 2019 for the University, and its impact on policies, procedures, and the consolidated financial statements is under evaluation.

In February 2016, the FASB issued ASU 2016-02, "Leases," new guidance to increase the transparency and comparability of lease reporting by recognizing lease assets and liabilities on the balance sheet and disclosing key information about leasing activities. The principal difference from previous guidance is that the lease assets and liabilities that arise from operating leases with terms greater than one year should be recognized in the statement of financial position. The standard is effective in fiscal year 2020 for the University, and its impact on policies, procedures, and the consolidated financial statements is under evaluation.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments—Overall: Recognition and Measurement of Financial Assets and Financial Liabilities," affecting accounting for equity investments and financial liabilities under the fair value option and certain presentation and disclosure requirements for financial instruments. The standard is effective in fiscal year 2019 for the University, and its impact on policies, procedures, and the consolidated financial statements is under evaluation.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers," a new revenue recognition topic in the Codification. In August 2015, ASU 2015-14 was issued to defer the effective date of ASU 2014-09 for all entities for one year. Now effective in fiscal year 2019 for the University, it provides a principle-based framework to replace earlier industry-specific and rule-based revenue recognition standards. Under the new ASU, revenue is recognized at an amount that reflects consideration to which the entity expects to be entitled from another entity in exchange for contracted services or goods that are an output of its ordinary activities. This approach requires use of more judgments and estimates by management, as well as more disclosures to describe estimation methods, inputs, and assumptions used. The University is evaluating the impact of its implementation on policies, procedures, and the consolidated financial statements.

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, 2016, from which the summarized information was derived.

Reclassifications

In 2017, the University identified that certain cash flows from changes in accounts payable and accrued expenses were not correctly classified on the fiscal 2016 consolidated statements of cash flows. The University revised the 2016 consolidated statements of cash flows to reflect accounts payable and accrued expenses of $17.7 million in net cash provided by operations, and acquisitions of land, buildings, and equipment of ($468.8 million) in net cash used in investing activities.

In 2017, the University identified that certain cash flows from changes in deposits and annuities payable were not correctly classified on the fiscal 2016 consolidated statements of cash flows. As a result, the University revised the 2016 consolidated statements of cash flows to reflect deposits and annuities payable of $17.1 million as net cash provided by operations, reclassified from net cash used in financing activities.

In 2017, the University also identified that certain cash flows from changes in purchases and sales of investments were not correctly classified on the fiscal 2016 consolidated statements of cash flows. As a result, the University revised the 2016 consolidated statements of cash flows to reflect a decrease to cash used in purchases of investments of $74.4 million for a total of ($1.6 billion) and a decrease to cash received from sales of investments ($74.4 million) for a total of $2.1 billion.

These revisions increased net cash used in operating activities by $29.3 million, increased net cash provided by investing activities by $46.4 million, and decreased net cash provided by financing activities by ($17.1 million) for fiscal year 2016.

The University believes the impact of the error is not material to the prior year consolidated financial statements.

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, 2017*	*August 31, 2016*
Research and other sponsored programs support	$85,760	$89,320
Student receivables	117,739	139,608
Royalty receivables	2,177	16,157
Other receivables	58,389	82,032
Accounts receivable subtotal	**264,065**	**327,117**
Less allowances for student uncollectible amounts	(641)	(671)
Total accounts receivable	**$263,424**	**$326,446**

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

(in thousands of dollars)	*August 31, 2017*	*August 31, 2016*
Notes receivable	$155,485	$159,917
Less allowances for student uncollectible amounts	(3,806)	(3,489)
Total notes receivable	**$151,679**	**$156,428**

Activity within the allowances was insignificant for fiscal years 2017 and 2016.

3. Contributions Receivable

Contributions receivable consisted of the following:

(in thousands of dollars)	*August 31, 2017*	*August 31, 2016*
Unconditional promises expected to be collected in		
Less than one year	$57,821	$47,660
One year to five years	181,136	150,658
More than five years	130,727	118,781
Fair value and other reserves		
Fair value adjustment	(48,976)	(47,133)
Other reserves	(1,928)	(6,543)
Total contributions receivable	**$318,780**	**$263,423**

Contributions receivable are discounted based on the US Department of the Treasury Daily Treasury Yield Curve Rates corresponding to the terms of the pledges receivable. In prior years, contributions receivable were 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 rates for pledges made in fiscal years 2017 and 2016 were 1.7 and 3.5 percent, respectively; the discount rates for pledges made in prior fiscal years ranged from 2.7 to 6.5 percent.

The next table summarizes the change in contributions receivable for the fiscal years ended August 31, 2017, and 2016.

(in thousands of dollars)	2017	2016
Balance—beginning of year	$263,423	$169,018
New pledges	117,320	170,498
Collections on pledges	(60,273)	(61,196)
Adjustments to pledges	(4,462)	(3,175)
Increase in discount to present value	(1,843)	(13,256)
Decrease in other reserves	4,615	1,534
Balance at end of year	**$318,780**	**$263,423**

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 tables show the estimated fair value of investments and derivatives, grouped by the valuation hierarchy as defined in note 1, as of August 31, 2017, and 2016:

(in thousands of dollars)					August 31, 2017
	Quoted prices in active markets (Level 1)	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**NAV as Practical Expedient (NAV)**	**Total fair value**
Cash and cash equivalents	$214,864	—	—	—	$214,864
US equity	594,477	$53,365	—	$757,237	1,405,079
International equity	282,996	19,638	$19	1,598,400	1,901,053
Fixed income	57,968	655,750	—	219,584	933,302
High-yield credit	—	—	—	334,441	334,441
Absolute return	49,951	50,806	—	1,888,951	1,989,708
Private investments	20,014	358	17,310	2,210,735	2,248,417
Real assets	103,536	16,612	112,719	1,367,522	1,600,389
Other investments	—	34,091	24,966	—	59,057
Interest-rate derivatives	4,000	(3,058)	—	—	942
Subtotal investment assets at fair value	**1,327,806**	**827,562**	**155,014**	**8,376,870**	**10,687,252**[a]
Interest-rate swaps	—	(20,830)	—	—	(20,830)
Total	**$1,327,806**	**$806,732**	**$155,014**	**$8,376,870**	**$10,666,422**

[a] Investments held at cost totaling $30,535 thousands should be added to the subtotal investment assets at fair value to reflect total investment assets as of August 31, 2017.

(in thousands of dollars)					*August 31, 2016*
	Quoted prices in active markets (Level 1)	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**NAV as Practical Expedient (NAV)**	**Total fair value**
Cash and cash equivalents	$152,016	—	—	—	$152,016
US equity	509,477	$61,730	$59	$695,733	1,266,999
International equity	283,385	19,643	1,329	1,261,153	1,565,510
Fixed income	124,448	963,490	—	215,523	1,303,461
High-yield credit	—	—	—	336,112	336,112
Absolute return	(474)	171,755	—	1,902,528	2,073,809
Private investments	—	321	14,752	2,014,860	2,029,933
Real assets	86,299	11,385	98,589	1,324,192	1,520,465
Other investments	—	7,926	23,488	—	31,414
Interest-rate derivatives	5,500	(4,942)	—	—	558
Subtotal investment assets at fair value	**1,160,651**	**1,231,308**	**138,217**	**7,750,101**	**10,280,277**[a]
Interest-rate swaps	—	(28,561)	—	—	(28,561)
Total	**$1,160,651**	**$1,202,747**	**$138,217**	**$ 7,750,101**	**$10,251,716**

[a] *Investments held at cost totaling $32,505 thousands should be added to the subtotal investment assets at fair value to reflect total investment assets as of August 31, 2016.*

Investments included as NAV as Practical Expedient consist primarily of the University's ownership in external investments (principally limited partnership interests in long-only equity and credit, 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. In cases where the practical expedient threshold is not met, such as an investment not being in compliance with GAAP, or where a statement of partners' capital is not provided, the investment is reported as Level 3. 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, 2017. The assessment may result in adjustment to the external managers' valuations of the securities' fair value if those valuations are not in accordance with GAAP. 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.

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, 2017, and 2016:

(in thousands of dollars)	*August 31, 2016*						*August 31, 2017*
	Fair value	**Purchases**	**Sales and settlements**	**Unrealized gains (losses)**	**Realized gains (losses)**	**Transfers into and out of Level 3**	**Fair value**
US equity securities	$59	—	($54)	—	($5)	—	$0
International equity	1,329	$198	(1,304)	($205)	—	—	18
Private investments	14,752	6,726	(575)	(3,080)	(513)	—	17,310
Real assets	98,589	12,714	(9,197)	16,422	(5,809)	—	112,719
Other investments	23,488	—	—	1,477	—	—	24,965
Total investments	**$138,217**	**$19,638**	**($11,130)**	**$14,614**	**($6,327)**	**—**	**$155,012**

(in thousands of dollars)	*August 31, 2015*						*August 31, 2016*
	Fair value	**Purchases**	**Sales and settlements**	**Unrealized gains (losses)**	**Realized gains (losses)**	**Transfers into and out of Level 3**	**Fair value**
US equity securities	—	$141	($91)	$74	($65)	—	$59
International equity	$63	1,089	—	656	(479)	—	1,329
Private investments	16,903	2,777	(671)	(4,257)	—	—	14,752
Real assets	101,502	10,346	(8,192)	(6,623)	1,556	—	98,589
Other investments	24,325	—	—	(837)	—	—	23,488
Total investments	**$142,793**	**$14,353**	**($8,954)**	**($10,987)**	**$1,012**	**—**	**$138,217**

There were no significant transfers or reclassifications between Levels 1 and 2 during fiscal years 2017 and 2016. In fiscal years 2017 and 2016, there were no transfers into or out of Level 3.

As of August 31, 2017, and 2016, investments held at cost included real estate totaling $19.4 million. Investments held at cost also included property co-ownerships, mortgages, and other investments totaling $11.1 million and $13.1 million as of August 31, 2017, and 2016, respectively.

The table on the next page 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, 2017, the University was committed to making future capital contributions in the amount of $2 billion, primarily in the next five years, as detailed in the table. 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	$1,405,079	No limit	—	Daily to annually, with 1- to 90-day notice periods	Lock-up provisions ranging from none to 3 years
International equity	1,901,053	No limit	$18,557	Daily to annually, with 1- to 90-day notice periods	Lock-up provisions ranging from none to 5 years
Fixed income	933,302	No limit	—	Daily to quarterly, with 1- to 90-day notice periods	No lock-up provisions
High-yield credit	334,441	No limit to 12 years	163,122	Certain partnerships ineligible for redemption; other funds semiannually to annually, with 90-day notice periods	Certain partnerships not redeemable; other partnerships include side pockets subject to general partner discretion
Absolute return	1,989,708	No limit	20,000	Daily to greater than annually, with 1- to 120-day notice periods; private partnership ineligible for redemption	Lock-up provisions ranging from none to 5 years; side pockets on many funds; one partnership not redeemable
Private investments	2,248,417	No limit to 12 years	944,352	Partnerships ineligible for redemption; equity securities daily, with 1-day notice period	Private partnerships not redeemable; no lock-up provisions on equity securities
Real assets	1,600,389	No limit to 14 years	854,279	Partnerships ineligible for redemption; commodity and equity funds weekly to quarterly, with 1- to 45-day notice periods	Drawdown partnerships not redeemable; no restriction on commodity and equity funds

Cash and cash equivalents for investment purposes include bank accounts holding cash and money market funds consisting of short-term US Treasury securities. Cash and cash equivalents are highly liquid and are carried at amortized cost, which approximates fair value.

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 over the next year.

International equities include developed market (ex–US public equities) and emerging market strategies. Two investments in this category may not be redeemed over the next year, while two others may only be partially redeemed.

Fixed income strategies include US government securities, agency securities, inflation-linked bonds (TIPS), corporate bonds, global bonds, and short-term cash investments.

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 tactical credit strategies. Six investments in this portfolio currently may not be redeemed over the next year due to lock-up provisions. As of August 31, 2017, the remaining investments have either full or partial liquidity over the next year, with the exception of those having side pockets.

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 and equity 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, 2017*	*August 31, 2016*
Investment income	$45,855	$52,987
Net realized gains	576,519	440,499
Net change in fair values, unrealized	464,992	(96,965)
Total investment return	**$1,087,366**	**$396,521**

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. In 2017, a $75 million one-time adjustment to payout in excess of the spending rule was authorized to support strategic investment and is included in the investment return designated for operations line of the statement of activities. Gross investment income from specific investments held at cost totaled $15.5 million and $13.7 million for the fiscal years ended August 31, 2017, and 2016, respectively. Investment expenses related to specific investments held at cost totaled $3 million and $2.8 million for the fiscal years ended August 31, 2017, and 2016, respectively. All other investment returns are categorized as nonoperating. As reflected in the consolidated statement of activities, investment return was as follows:

(in thousands of dollars)	*August 31, 2017*	*August 31, 2016*
Changes in unrestricted net assets		
Operating: investment return	$370,137	$357,775
Operating: investment return to support strategic investment	75,000	—
Nonoperating: investment returns, reduced by operating distribution	293,052	(10,073)
Changes in temporarily restricted net assets		
Operating: investment return	159,397	151,234
Nonoperating: investment returns, reduced by operating distribution	189,780	(102,415)
Total investment return	**$1,087,366**	**$396,521**

Certain expenses paid directly by the University for investment management and custody services totaled $65.4 million and $56 million for the fiscal years ended August 31, 2017, and 2016, 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. These instruments are held in the fixed income asset class of investments within Level 2.

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, 2017, the University posted collateral of $4 million to 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. 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.

For further discussion of credit-related derivatives, see note 8.

The following tables summarize the derivative financial instruments held by the University as of August 31, 2017, and 2016:

(in thousands of dollars) *August 31, 2017*

	Notional amount	Assets	Liabilities	Fiscal year net gain (loss)
Investment-related derivatives				
Interest-rate swaptions	$200,000	$4,000	($3,058)	($145)
Equity futures	60,252	4,443	—	8,179
Total investment-related	**260,252**	**8,443**	**(3,058)**	**8,034**
Credit-related derivatives				
Interest-rate swaps	125,000	—	(20,830)	7,732
Total credit-related	**125,000**	—	**(20,830)**	**7,732**
Total derivative financial instruments	**$385,252**	**$8,443**	**($23,888)**	**$15,766**

(in thousands of dollars) *August 31, 2016*

	Notional amount	Assets	Liabilities	Fiscal year net gain (loss)
Investment-related derivatives				
Interest-rate swaptions	$400,000	$5,500	($4,942)	($2,360)
Equity futures	52,701	4,451	—	3,091
Total investment-related	**452,701**	**9,951**	**(4,942)**	**731**
Credit-related derivatives				
Interest-rate swaps	125,000	—	(28,561)	(1,557)
Total credit-related	**125,000**	—	**(28,561)**	**(1,557)**
Total derivative financial instruments	**$577,701**	**$9,951**	**($33,503)**	**($826)**

5. Land, Buildings, and Equipment

Land, buildings, and equipment consisted of the following:

(in thousands of dollars)	*August 31, 2017*	*August 31, 2016*
Land	$31,036	$29,089
Construction in progress	688,360	606,726
Buildings and leasehold improvements	3,278,609	2,712,816
Equipment	607,409	552,482
Accumulated depreciation	(1,671,735)	(1,532,515)
Total land, buildings, and equipment	**$2,933,679**	**$2,368,598**

Included in construction-in-progress costs are building and leasehold improvement capitalizations. Building costs are funded by bonds, 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 asset's total cost and depreciated over the asset's useful life. Assets may include buildings and major equipment.

Asset Retirement Obligations

Asset retirement obligations (ARO) were adjusted during fiscal years 2017 and 2016 as follows:

(in thousands of dollars)	*August 31, 2017*	*August 31, 2016*
Balance at beginning of year	$2,940	$121,035
Liabilities added (settled) in current period	178	(2,780)
Accretion expense	132	5,827
Change in estimated cash flows	—	(121,142)
Balance at end of year	**$3,250**	**$2,940**

In fiscal year 2016, management made a change in estimate of ARO based on an enhanced evaluation methodology, performance of a comprehensive study, and recalculations of remediation risks, assumptions, and costs. As a result of a change in estimate, the adjustment to the ARO liability eliminated the net asset retirement cost and reduced the net book value of the associated fixed assets, resulting in a nonoperating gain. Building assets were reduced by $62.9 million and accumulated depreciation was reduced by $13.6 million on the consolidated statements of financial position, and a nonoperating gain of $71.9 million was recorded on the consolidated statement of activities.

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 2031. Real estate lease expenses totaled $13.4 million and $12.5 million for the fiscal years ended August 31, 2017, and 2016, respectively. Sublease rentals totaled $2.9 million and $3 million for the fiscal years ended August 31, 2017, and 2016, respectively. At August 31, 2017, there were no subleases that are noncancelable for one year or more. The future minimum lease payments under noncancelable operating leases through August 31 of each period are shown at right.

(in thousands of dollars)	
2018	$14,917
2019	15,270
2020	14,763
2021	13,299
2022	11,910
2023 and thereafter	50,884
Total	**$121,043**

Rentals under Leases

The University is entitled under numerous operating leases to receive rental payments. Operating leases consist primarily of leases for the use of real property and have terms expiring in various years through fiscal year 2021. The future minimum rental payments under noncancelable operating leases through August 31 of each period are shown at right.

(in thousands of dollars)	
2018	$1,166
2019	870
2020	97
2021	35
2022	—
2023 and thereafter	—
Total	**$2,168**

6. Other Assets

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

(in thousands of dollars)	*August 31, 2017*	*August 31, 2016*
Prepaid bond expenses	$8,478	$8,816
Inventories	2,707	2,602
Other assets	6,788	5,707
Total other assets	**$17,973**	**$17,125**

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, 2017*	*August 31, 2016*
Agency deposits payable	$119,777	$87,804
Actuarial liability of annuities payable	20,239	21,882
Student loan deposits payable	7,981	10,436
Other deposits payable	8,182	20,714
Total deposits payable and actuarial liability of annuities payable	**$156,179**	**$140,836**

8. Bonds, Notes, and Other Debt Payable

Bonds and notes payable are as follows:

(in thousands of dollars)	*August 31, 2017*	*August 31, 2016*
Illinois Finance Authority (IFA)–Series 2004	$135,800	$135,800
IFA–Series 2008	125,000	125,000
Taxable–Series 2012	200,000	200,000
Taxable–Series 2013	572,945	577,660
Less unamortized loss on Taxable–Series 2013	(2,247)	(2,349)
Taxable–Series 2015	500,000	500,000
Less unamortized loss on Taxable–Series 2015	(611)	(634)
IFA–Series 2015	128,545	128,545
Plus unaccreted premium on Tax-Exempt–Series 2015	13,978	15,142
Bonds payable subtotal	**1,673,410**	**1,679,164**
Commercial paper, taxable	145,000	230,000
Promissory note	32,000	—
Less unamortized discount on promissory note	(1,330)	—
Notes payable subtotal	**175,670**	**230,000**
Other debt payable—lines of credit	200,000	—
Total bonds, notes, and other debt payable	**$2,049,080**	**$1,909,164**

Debt issuance	**Interest-rate mode**	**Interest rate**	**Maturity**
IFA–Series 2004	Variable	0.74%[a]	December 1, 2034
IFA–Series 2008	Variable	0.75%[a]	December 1, 2046
Taxable–Series 2012	Fixed	4.2%	December 1, 2039, to December 1, 2047
Taxable–Series 2013	Fixed	4.54%[b]	December 1, 2015, to December 1, 2044
Taxable–Series 2015	Fixed	3.78%[b]	December 1, 2038, to December 1, 2048
IFA–Series 2015	Fixed	4.24%[b]	December 1, 2022, to December 1, 2028
Commercial paper, taxable	Variable	1.22%[b]	September 12 to 29, 2017
Promissory note	Fixed	1.72%	July 1, 2021
Lines of credit, taxable	Variable	1.7%[b]	September 21 to October 3, 2017

[a] *Interest rate reset weekly*

[b] *Weighted average interest rate at August 31, 2017*

Total obligations including bonds, notes, and other debt payable at August 31, 2017, 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, 2017. 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)

2018	$357,635
2019	12,667
2020	12,686
2021	12,922
2022	4,790
Thereafter	1,637,260
Total	**$2,037,960**

Bonds Payable

The IFA–Series 2015 Revenue Bonds were issued to acquire, construct, renovate, improve, and equip certain educational facilities of the University as defined in the Illinois Finance Authority Act and to pay certain expenses incurred in connection with the issuance of the bonds as permitted under the Illinois Finance Authority Act, subject to conditions set forth in a trust indenture between the Illinois Finance Authority (IFA) and Wells Fargo Bank, National Association (NA); and a loan agreement between the University and the IFA.

The Taxable–Series 2015 Fixed Rate Bonds were issued to acquire, construct, renovate, and equip certain educational facilities of the University, to refund $145.1 million of the University's outstanding IFA–Series 2006 Revenue Bonds, and to pay certain expenses incurred in connection with the redemption and the issuance of the bonds, subject to conditions set forth in a trust indenture between the University and Wells Fargo Bank, NA.

The Taxable–Series 2013 Fixed Rate Bonds were issued to acquire, construct, renovate, and equip certain educational facilities of the University, to refund $185 million of the University's outstanding IEFA–Series 2003 Fixed Rate Revenue Bonds, and to pay certain expenses incurred in connection with the redemption and issuance of the bonds, subject to conditions set forth in a trust indenture between the University and Wells Fargo Bank, NA.

The Taxable–Series 2012 Fixed Rate Bonds were issued to acquire, construct, and equip 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, NA.

The IFA–Series 2008 Adjustable Rate Revenue Bonds were issued to acquire, construct, renovate, remodel, improve, and equip certain educational facilities of the University as defined in the Illinois Finance Authority Act and to pay certain expenses incurred in connection with the issuance of the bonds as permitted under the Illinois Finance Authority Act, subject to conditions set forth in a trust indenture between the IFA and Wells Fargo Bank, NA; and a loan agreement between the University and the IFA. The bonds may operate in a daily, weekly, adjustable, or auction-rate mode.

The IFA–Series 2004 Adjustable Rate Revenue Bonds were issued to acquire, construct, renovate, improve, and equip certain educational facilities of the University as defined in the Illinois Finance Authority Act and to pay certain expenses incurred in connection with the issuance of the bonds as permitted under the Illinois Finance Authority Act, subject to conditions set forth in a trust indenture between the IFA and Wells Fargo Bank, NA; and a loan agreement between the University and the IFA. The bonds may operate in a daily, weekly, adjustable, or auction-rate mode.

Derivative Financial Instruments

The University has entered into interest-rate swap agreements to hedge variable interest-rate exposure related to its variable rate debt. The agreements effectively fix the interest rate from 4.12 percent to 4.38 percent. The notional value is $125 million through expiration on August 31, 2023.

The University recognized a net unrealized gain on the swap investment totaling $7.7 million for the fiscal year ended August 31, 2017, and a net unrealized loss of $1.6 million for the fiscal year ended August 31, 2016. The fair values of the swap position were in a liability position of $20.8 million and $28.6 million as of August 31, 2017, and 2016, respectively, and are included in accounts payable and accrued expenses on the consolidated statements of financial position. Also see note 4.

Notes Payable

The University places commercial paper under a $300 million Taxable Commercial Paper Note. In fiscal year 2017, the University recorded a $32 million four-year promissory note related to the purchase of a building.

Other Debt Payable

At August 31, 2017, the University held or had the ability to draw $350 million in standby lines of credit to supplement working capital requirements as follows:

(in thousands of dollars)

Expiration date	Available credit
December 8, 2017[a]	$25,000
March 31, 2018	75,000
June 30, 2018	25,000
July 20, 2018	125,000
June 30, 2019	50,000
October 17, 2019	50,000
Total	**$350,000**

[a] *Renewed December 8, 2017, through December 7, 2018.*

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
- Possible effects of inflation or deflation
- 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 2,600 individual donor-restricted endowment funds and about 1,000 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 as of August 31, 2017, and 2016:

(in thousands of dollars) *August 31, 2017*

Endowment net asset composition by type of fund	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	($57)	$2,422,041	$1,483,792	$3,905,776
Institution-designated endowment funds	4,041,798			4,041,798
Total endowment funds	**$4,041,741**	**$2,422,041**	**$1,483,792**	**$7,947,574**

(in thousands of dollars) *August 31, 2016*

Endowment net asset composition by type of fund	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	($3,039)	$2,235,406	$1,411,130	$3,643,497
Institution-designated endowment funds	3,834,670			3,834,670
Total endowment funds	**$3,831,631**	**$2,235,406**	**$1,411,130**	**$7,478,167**

Investment and Spending Policies

The University's endowment is primarily invested in the Long-Term Balanced Pool. 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 changes in endowment net assets for the years ended August 31, 2017, and 2016:

(in thousands of dollars)				*August 31, 2017*
	Unrestricted	**Temporarily restricted**	**Permanently restricted**	**Total**
Endowment net assets, beginning of year	$3,831,631	$2,235,406	$1,411,130	$7,478,167
Net investment loss	(6,188)	(6,247)	—	(12,435)
Net appreciation, realized and unrealized	357,024	354,471	—	711,495
Total investment return	**350,836**	**348,224**	**—**	**699,060**
Contributions		1,400	56,575	57,975
Appropriation of endowment assets for expenditure	(164,091)	(159,515)	—	(323,606)
Other changes				
Transfers to create institutional funds	66,740	—	—	66,740
Transfers of institutional funds per donor requirement		368	12,305	12,673
Spending of institution-designated endowment fund	(43,435)	—	—	(43,435)
Other reclassifications	60	(3,842)	3,782	—
Endowment net assets, end of year	**$4,041,741**	**$2,422,041**	**$1,483,792**	**$7,947,574**

(in thousands of dollars)				*August 31, 2016*
	Unrestricted	**Temporarily restricted**	**Permanently restricted**	**Total**
Endowment net assets, beginning of year	$3,911,697	$2,333,376	$1,342,956	$7,588,029
Net investment loss	(4,824)	(7,189)	—	(12,013)
Net appreciation, realized and unrealized	32,527	54,829	—	87,356
Total investment return	**27,703**	**47,640**	**—**	**75,343**
Contributions		285	63,747	64,032
Appropriation of endowment assets for expenditure	(158,125)	(151,234)	—	(309,359)
Other changes				
Transfers to create institutional funds	139,902	—	—	139,902
Transfers of institutional funds per donor requirement		173	6,425	6,598
Spending of institution-designated endowment fund	(86,378)	—	—	(86,378)
Other reclassifications	(3,168)	5,166	(1,998)	—
Endowment net assets, end of year	**$3,831,631**	**$2,235,406**	**$1,411,130**	**$7,478,167**

Underwater Endowment Funds

The University monitors endowment funds to identify those for which historical cost was more than fair value. As of August 31, 2017, and 2016, the historical cost of such accounts was approximately $1.9 million and $196 million, and the market value totaled $1.8 million and $193 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 $77 million and $71.1 million to the two plans in 2017 and 2016, respectively. It expects to contribute $79.8 million to the two plans in 2018.

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 $10.1 million and $11.3 million at August 31, 2017, and 2016, 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 consolidated 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 statement 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, 2017*	*August 31, 2016*
Benefit obligations	$15,691	$14,273
Benefits paid	1,003	930
Employer contributions	387	334
Contributions from participants	617	596
Net periodic postretirement benefit cost	985	857
Fair value of plan assets	—	—

The accumulated other comprehensive income included in unrestricted net assets on the consolidated statements of financial position totaled net gains of $0.8 million and $1.6 million as of August 31, 2017, and 2016, respectively; a decrease of $0.8 million due to net losses during the fiscal year.

The APBO was $15.7 million and $14.3 million at August 31, 2017, and 2016, 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, 2017, and 2016. For both fiscal years 2017 and 2016, the ultimate healthcare cost trend rate was 5 percent, and the year when the trend rate will reach the ultimate trend rate was 2025.

Additional assumptions used to determine benefit obligations were as follows:

	August 31, 2017	*August 31, 2016*
Settlement (discount) rate	3.3%	3%
Weighted average rate of increase in future compensation levels	3%	3%
Healthcare cost trend rate	7%	6.75%

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

	August 31, 2017	*August 31, 2016*
Discount rate	3%	3.9%
Weighted average rate of increase in future compensation levels	3%	3%
Healthcare cost trend rate	6.75%	7%

A one-percentage-point change in assumed healthcare cost trend rates would have had these effects in fiscal year 2017:

(in thousands of dollars)	*1% point decrease*	*1% point increase*
(Decrease) increase in total of service and interest cost	($61)	$70
(Decrease) increase in postretirement benefit obligation	(584)	656

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

(in thousands of dollars)	
2018	$893
2019	644
2020	771
2021	850
2022	942
2023–27	5,548
Total	**$9,648**

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 $76.5 million and $64.6 million in fiscal years 2017 and 2016, 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 Group (NMG) is a not-for-profit, 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). NMG is governed by a board of directors, and its physicians are full-time faculty members or researchers at Feinberg. It is a wholly owned subsidiary of Northwestern Memorial Healthcare Corporation (NMHC), the not-for-profit parent corporation of Northwestern Memorial Hospital (NMH), which is the primary teaching hospital of Feinberg. As such, NMHC and NMG are related parties of the University. Under terms of agreements effective in fiscal year 2014 between the University, NMG, and NMHC, the University receives recurring contributions from NMHC to support the Feinberg research and education programs, basic and applied biomedical research facilities and programs, and research and educational support services.

As of August 31, 2017, accounts receivable arising from support and operational activities with NMHC totaled $17 million and are included in accounts receivable on the consolidated statements of financial position. Through August 31, 2017, contributions totaling $114.4 million have been made from NMHC to the University and are included in private gifts on the consolidated statement of activities.

As of August 31, 2016, accounts receivable arising from support and operational activities with NMHC totaled $18.5 million and are included in accounts receivable on the consolidated statements of financial position. Through August 31, 2016, contributions totaled $133.8 million from NMHC to the University; these are included in private gifts on the consolidated statement of activities.

12. Self-Insurance Reserves and Other Contingencies

Reserves for losses under the University's self-insurance program, aggregating $8 million and $7.3 million at August 31, 2017, and 2016, respectively, include reserves for probable known losses and for losses incurred but not yet reported. The reserves are presented on a discounted basis. The discount rate was 7.5 percent in fiscal years 2017 and 2016. 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 in effect through fiscal year 2013 between the University and NMG, a proportionate share of primary medical professional liability costs that arise out of events prior to November 1, 2004, was borne by NMG. As a part of the clinical integration agreement between NMG, NMHC, and the University, signed September 1, 2013, any remaining liabilities related to the period prior to November 1, 2004, are the obligations of the University and included in the reserves, beginning in fiscal year 2014, for losses noted above.

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 $20.6 million and $29.3 million as of August 31, 2017, and

2016, 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 $74,000 and $100,000 at August 31, 2017, and 2016, respectively. Notes receivable on the consolidated statements of financial position are shown net of these reserves in fiscal years 2017 and 2016.

In October 2013, the University purchased a $61 million portfolio of private education loans from a lending agency; these loans were previously purchased by the lending agency from the University prior to 2009 and were serviced by the University. As of August 31, 2017, and 2016, respectively, these loans totaled $23.1 million and $30.6 million, and are included in notes receivable on the consolidated statements of financial position. The University continues to service the repurchased loans. At August 31, 2017, and 2016, $83,000 and $104,000, 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 2017 and 2016.

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 statement of activities as follows:

(in thousands of dollars)	*August 31, 2017*	*August 31, 2016*
Federal grants	$461,741	$444,304
Private grants and contracts	151,041	147,960
State grants	4,666	3,510
Total grants and contracts	**$617,448**	**$595,774**

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, 2017, and 2016, were as follows:

(in thousands of dollars) *August 31, 2017*

	Maintenance of facilities	Depreciation and accretion	Interest on indebtedness	All other operating expenses	Total
Instruction	$26,488	$20,705	$6,404	$832,301	$885,898
Research	47,272	36,952	11,430	398,801	494,455
Academic support	36,419	28,469	8,806	205,578	279,272
Student services	23,262	18,184	5,625	181,574	228,645
Institutional support	10,804	8,445	2,612	276,348	298,209
Auxiliary services	39,295	30,716	9,501	31,305	110,817
Total	**$183,540**	**$143,471**	**$44,378**	**$1,925,907**	**$2,297,296**

(in thousands of dollars) *August 31, 2016*

	Maintenance of facilities	Depreciation and accretion	Interest on indebtedness	All other operating expenses	Total
Instruction	$26,936	$18,154	$5,930	$771,599	$822,619
Research	48,148	32,452	10,599	371,850	463,049
Academic support	34,682	23,375	7,635	217,736	283,428
Student services	21,728	14,645	4,783	157,574	198,730
Institutional support	9,628	6,489	2,120	272,242	290,479
Auxiliary services	41,707	28,110	9,181	28,851	107,849
Total	**$182,829**	**$123,225**	**$40,248**	**$1,819,852**	**$2,166,154**

15. Subsequent Event

The University has evaluated subsequent events in accordance with the FASB ASC Subsequent Event Topic through January 10, 2018, the date when financial statements were issued. The following event was identified: In October 2017, the University issued $500 million in taxable bonds with an average interest rate of 3.73 percent. Proceeds from this issuance will be used to finance capital construction.

Administration and Trustees

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