# UNIVERSITY OF PITTSBURGH

# FINANCIAL REPORT
# FISCAL YEAR 2011

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## Independent Auditors' Report

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

We have audited the accompanying consolidated balance sheets of the University of Pittsburgh – Of the Commonwealth System of Higher Education (the University) as of June 30, 2011 and 2010, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the University of Pittsburgh – Of the Commonwealth System of Higher Education as of June 30, 2011 and 2010, and the results of their changes in net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

September 21, 2011

UNIVERSITY OF PITTSBURGH
CONSOLIDATED BALANCE SHEETS
JUNE 30, 2011 AND 2010
*(in thousands of dollars)*

| | 2011 | 2010 |
|---|---|---|
| **ASSETS:** | | |
| Cash and cash equivalents | $ 87,061 | $ 175,362 |
| Operating investments *(Notes 4 and 5)* | 621,599 | 588,295 |
| Investments held under securities lending program *(Note 1)* | 101,855 | 89,988 |
| Accounts and notes receivable, net *(Note 2)* | 154,188 | 153,260 |
| Inventories and deferred charges | 22,838 | 22,265 |
| Contributions receivable, net *(Note 3)* | 52,282 | 54,963 |
| Student loans receivable, net | 47,078 | 47,716 |
| Deposits with bond trustees *(Note 5)* | 49,144 | 126,999 |
| Investments in foundations | 24,765 | 21,703 |
| Endowment investments *(Notes 4 and 5)* | 2,545,092 | 2,048,024 |
| Endowed funds held by third parties | 19,264 | 16,519 |
| Property, plant, and equipment, net *(Note 6)* | 1,674,757 | 1,581,433 |
| **TOTAL ASSETS** | $ 5,399,923 | $ 4,926,527 |
| **LIABILITIES:** | | |
| Accounts payable | $ 95,849 | $ 76,576 |
| Accrued payroll and related liabilities | 69,638 | 72,229 |
| Deferred student and other revenue | 39,774 | 36,036 |
| Liabilities under securities lending program *(Note 1)* | 101,855 | 89,988 |
| Advanced receipt of sponsored research funds | 80,056 | 85,983 |
| Refundable U.S. government student loans | 32,259 | 31,829 |
| Pension and postretirement obligations *(Note 10)* | 305,245 | 303,613 |
| Other liabilities *(Note 9)* | 110,836 | 122,086 |
| Conditional asset remediation obligation *(Note 7)* | 40,859 | 40,303 |
| Bonds and notes payable *(Note 8)* | 1,032,598 | 1,181,200 |
| **TOTAL LIABILITIES** | 1,908,969 | 2,039,843 |
| **NET ASSETS:** | | |
| Unrestricted | 2,283,697 | 1,874,399 |
| Temporarily restricted *(Notes 1 and 11)* | 652,304 | 474,590 |
| Permanently restricted *(Notes 1 and 11)* | 554,953 | 537,695 |
| **TOTAL NET ASSETS** | 3,490,954 | 2,886,684 |
| **TOTAL LIABILITIES AND NET ASSETS** | $ 5,399,923 | $ 4,926,527 |

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

UNIVERSITY OF PITTSBURGH
CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2011
COMPARED TO SUMMARY INFORMATION FOR THE YEAR ENDED JUNE 30, 2010
*(in thousands of dollars)*

| | 2011 | | | | |
|---|---|---|---|---|---|
| **REVENUES:** | Unrestricted | Temporarily Restricted | Permanently Restricted | Total | 2010 |
| Tuition and fees | $ 642,298 | $ - | $ - | $ 642,298 | $ 600,772 |
| Tuition discounts | (150,823) | - | - | (150,823) | (143,451) |
| Net tuition | 491,475 | - | - | 491,475 | 457,321 |
| Commonwealth appropriation | 184,562 | - | - | 184,562 | 185,407 |
| Commonwealth grants and contracts | 33,859 | - | - | 33,859 | 36,147 |
| Research grants and contracts | 722,599 | - | - | 722,599 | 693,363 |
| Research grants and contracts - ARRA | 78,637 | - | - | 78,637 | 43,662 |
| Gifts and contributions | 39,727 | 14,310 | 14,462 | 68,499 | 54,013 |
| Endowment earnings | 21,856 | 145 | 2,491 | 24,492 | 17,140 |
| Investment income | 12,727 | - | 140 | 12,867 | 14,731 |
| Sales and services, educational and other | 126,386 | - | - | 126,386 | 121,919 |
| Sales and services, auxiliary | 129,926 | - | - | 129,926 | 124,798 |
| Rental revenue | 18,524 | - | - | 18,524 | 19,360 |
| Other | 69,802 | - | - | 69,802 | 77,269 |
| Net assets released from restrictions | 14,471 | (14,471) | - | - | - |
| **Total revenues** | 1,944,551 | (16) | 17,093 | 1,961,628 | 1,845,130 |
| **EXPENSES:** | | | | | |
| Salaries and wages | 840,039 | - | - | 840,039 | 796,200 |
| Fringe benefits | 252,774 | - | - | 252,774 | 240,684 |
| Total compensation | 1,092,813 | - | - | 1,092,813 | 1,036,884 |
| Supplies | 120,832 | - | - | 120,832 | 118,325 |
| Business and professional | 300,123 | - | - | 300,123 | 265,163 |
| Utilities | 51,193 | - | - | 51,193 | 54,661 |
| Maintenance and facilities | 44,600 | - | - | 44,600 | 41,024 |
| Depreciation | 134,195 | - | - | 134,195 | 122,886 |
| Interest | 45,892 | - | - | 45,892 | 55,306 |
| Other | 61,016 | - | - | 61,016 | 62,246 |
| **Total expenses *(Note 12)*** | 1,850,664 | - | - | 1,850,664 | 1,756,495 |
| **Revenues less expenses** | 93,887 | (16) | 17,093 | 110,964 | 88,635 |
| **OTHER ACTIVITIES:** | | | | | |
| Realized/unrealized gains on investments and swaps | 299,070 | 177,730 | 165 | 476,965 | 205,520 |
| Pension and postretirement changes other than net periodic cost | 16,341 | - | - | 16,341 | (7,158) |
| **Total other activities** | 315,411 | 177,730 | 165 | 493,306 | 198,362 |
| **CHANGE IN NET ASSETS** | 409,298 | 177,714 | 17,258 | 604,270 | 286,997 |
| **NET ASSETS, BEGINNING OF YEAR** | 1,874,399 | 474,590 | 537,695 | 2,886,684 | 2,599,687 |
| **NET ASSETS, END OF YEAR** | $ 2,283,697 | $ 652,304 | $ 554,953 | $ 3,490,954 | $ 2,886,684 |

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

UNIVERSITY OF PITTSBURGH
CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2010
*(in thousands of dollars)*

| | 2010 | | | |
|---|---|---|---|---|
| **REVENUES:** | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
| Tuition and fees | $ 600,772 | $ - | $ - | $ 600,772 |
| Tuition discounts | (143,451) | - | - | (143,451) |
| Net tuition | 457,321 | - | - | 457,321 |
| Commonwealth appropriation | 185,407 | - | - | 185,407 |
| Commonwealth grants and contracts | 36,147 | - | - | 36,147 |
| Research grants and contracts | 693,363 | - | - | 693,363 |
| Research grants and contracts - ARRA | 43,662 | - | - | 43,662 |
| Gifts and contributions | 31,845 | 5,498 | 16,670 | 54,013 |
| Endowment earnings | 15,151 | - | 1,989 | 17,140 |
| Investment income | 14,558 | - | 173 | 14,731 |
| Sales and services, educational and other | 121,919 | - | - | 121,919 |
| Sales and services, auxiliary | 124,798 | - | - | 124,798 |
| Rental revenue | 19,360 | - | - | 19,360 |
| Other | 77,269 | - | - | 77,269 |
| Net assets released from restrictions | 15,831 | (15,831) | - | - |
| **Total revenues** | 1,836,631 | (10,333) | 18,832 | 1,845,130 |
| **EXPENSES:** | | | | |
| Salaries and wages | 796,200 | - | - | 796,200 |
| Fringe benefits | 240,684 | - | - | 240,684 |
| Total compensation | 1,036,884 | - | - | 1,036,884 |
| Supplies | 118,325 | - | - | 118,325 |
| Business and professional | 265,163 | - | - | 265,163 |
| Utilities | 54,661 | - | - | 54,661 |
| Maintenance and facilities | 41,024 | - | - | 41,024 |
| Depreciation | 122,886 | - | - | 122,886 |
| Interest | 55,306 | - | - | 55,306 |
| Other | 62,246 | - | - | 62,246 |
| **Total expenses *(Note 12)*** | 1,756,495 | - | - | 1,756,495 |
| **Revenues less expenses** | 80,136 | (10,333) | 18,832 | 88,635 |
| **OTHER ACTIVITIES:** | | | | |
| Realized/unrealized gains (losses) on investments and swaps | 150,781 | 55,050 | (311) | 205,520 |
| Pension and postretirement changes other than net periodic cost | (7,158) | - | - | (7,158) |
| **Total other activities** | 143,623 | 55,050 | (311) | 198,362 |
| **CHANGE IN NET ASSETS** | 223,759 | 44,717 | 18,521 | 286,997 |
| **NET ASSETS, BEGINNING OF YEAR** | 1,650,640 | 429,873 | 519,174 | 2,599,687 |
| **NET ASSETS, END OF YEAR** | $ 1,874,399 | $ 474,590 | $ 537,695 | $ 2,886,684 |

UNIVERSITY OF PITTSBURGH
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010
*(in thousands of dollars)*

| | 2011 | 2010 |
|---|---|---|
| **CASH AND CASH EQUIVALENTS:** | | |
| End of year | $ 87,061 | $ 175,362 |
| Beginning of year | 175,362 | 210,436 |
| **CHANGE IN CASH AND CASH EQUIVALENTS** | $ (88,301) | $ (35,074) |
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | |
| Change in net assets | $ 604,270 | $ 286,997 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Depreciation and net bond premium accretion | 123,448 | 119,192 |
| Loss on disposal of plant assets | 1,639 | 2,048 |
| Realized/unrealized gains on investments and swaps | (476,965) | (205,520) |
| Contributions restricted for long-term investment | (54,888) | (57,342) |
| Changes in operating assets and liabilities: | | |
| Accounts, notes, contributions, and student loans receivable, net | 4,229 | 28,704 |
| Other assets | (573) | (2,841) |
| Accounts payable | 7,058 | 252 |
| Pension and postretirement obligations | 1,632 | 29,481 |
| Conditional asset remediation obligation | 556 | 3,196 |
| Other liabilities | (412) | (3,058) |
| Government student loans and deferred revenue | (1,759) | 2,914 |
| **Net cash provided by operating activities** | 208,235 | 204,023 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | |
| Expended for property, plant, and equipment - University | (195,299) | (159,023) |
| Expended for property, plant, and equipment - commonwealth | (33,859) | (36,147) |
| Change in accounts payable for property, plant, and equipment | 12,215 | (1,970) |
| Change in investments held under securities lending program | (11,867) | (26,135) |
| Change in liabilities under securities lending program | 11,867 | 26,135 |
| Purchases/sales of nonendowment investments, net | (36,934) | (92,154) |
| Purchases of endowment investments | (580,954) | (1,559,701) |
| Proceeds from sales/maturities of endowment investments | 549,214 | 1,387,626 |
| Change in endowed funds held by third parties | (2,745) | (959) |
| Change in investments in foundations | (3,062) | (720) |
| **Net cash used for investing activities** | (291,424) | (463,048) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | |
| Principal repayment of debt | (253,880) | (29,900) |
| Proceeds from issuance of debt | 116,025 | 127,552 |
| Change in deposits with bond trustees | 77,855 | 68,957 |
| Contributions restricted for long-term investment | 54,888 | 57,342 |
| **Net cash provided (used) for financing activities** | (5,112) | 223,951 |
| **CHANGE IN CASH AND CASH EQUIVALENTS** | $ (88,301) | $ (35,074) |
| **Supplemental disclosure of cash flow information:** | | |
| **Cash paid for interest (excluding fees)** | $ 57,422 | $ 57,227 |
| **Noncash investing activity for property, plant, and equipment—accounts payable** | $ 40,084 | $ 27,869 |

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

## Note 1: Summary of Significant Accounting and Reporting Practices

**Organization**

Founded in 1787, the University of Pittsburgh of the Commonwealth System of Higher Education (the University) is an institution of higher education with a three-pronged mission to provide the highest-quality instruction for its students; engage in innovative research activities; and support the state and local community through public service programs. In its 224 year history, the University has evolved into an internationally recognized center of learning and research. The University's Oakland campus in the City of Pittsburgh is comprised of 16 schools and several academic centers educating nearly 29,000 students in various undergraduate, graduate, and first professional programs. Four regional campuses with a total enrollment approximating 7,000 students are located throughout western Pennsylvania.

**Relationship with the Commonwealth of Pennsylvania**

The University derives its corporate existence under the laws of the Commonwealth of Pennsylvania (the commonwealth) by reason of the act of the General Assembly of the commonwealth establishing an "Academy or Public School in the town of Pittsburgh" on February 28, 1787 and from the act of February 18, 1819 incorporating the "Western University of Pennsylvania." On July 11, 1908, the University's name was changed to the "University of Pittsburgh" by order of the Court of Common Pleas of Allegheny County. On July 28, 1966, the Pennsylvania State Legislature enacted the "University of Pittsburgh-Commonwealth Act," which changed the name of the University to the "University of Pittsburgh – of the Commonwealth System of Higher Education" and established the University as an instrumentality of the commonwealth to serve as a state-related institution in the commonwealth system of higher education. The University is a Pennsylvania nonprofit corporation subject to the Nonprofit Corporation Law of 1988.

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

As a state-related institution, the University receives an annual operating appropriation from the commonwealth. The appropriation is subject to the commonwealth's annual budget process. There is no assurance that such appropriation will continue to be made, or will be made, at current levels or at levels requested by the University. The appropriation from the commonwealth was $184.6 million in 2011 and $185.4 million in 2010. In addition, in 2010 the University received $8.6 million from the commonwealth for 2009 stabilization, which is included in other revenues in the 2010 Consolidated Statement of Activities. Amounts received from the commonwealth are subject to an annual audit by the auditor general of the commonwealth.

In addition to the annual appropriation, the commonwealth also funds certain capital projects in support of the University's academic mission. Amounts funded by the commonwealth for capital projects were $33.9 million in 2011 and $36.1 million in 2010.

**Basis of Presentation**

The consolidated financial statements include the accounts of the University and the net assets of three regional campus foundations. These consolidated financial statements do not include the net assets or activities of the University of Pittsburgh Medical Center (UPMC) or the University of Pittsburgh Physicians (UPP) clinical practice plans, as they are separate legal entities not controlled by the University. The University does have the right to designate one-third of the members of the UPMC Governing Board and its Executive Committee. Intercompany balances and transactions have been eliminated in consolidation.

**Basis of Accounting**

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

In accordance with GAAP, the University's net assets have been classified as either unrestricted, temporarily restricted, or permanently restricted based upon the existence or absence of donor-imposed restrictions. Unrestricted net assets are not subject to donor-imposed restrictions and are used for general operating purposes of the University. This class of net assets also includes certain gifts and endowment earnings whose donor-imposed restrictions have been met within the fiscal year. Temporarily restricted net assets are subject to certain time or purpose restrictions by the donor. Upon satisfaction of these restrictions, the net assets are transferred to unrestricted. Temporarily restricted net assets at June 30, 2011 and 2010 consist of endowment balances ($618.6 million and $441.0 million, respectively); the net present value of temporarily restricted gifts and unconditional promises to give ($30.0 million and $27.6 million, respectively); and split-interest agreements ($3.7 million and $6.0 million, respectively). Permanently restricted net assets are those subject to permanent donor-imposed restrictions and at June 30, 2011 and 2010 consist of endowment balances ($519.7 million and $499.2 million, respectively); unconditional promises to give ($23.8 million and $27.4 million, respectively); and private loan funds ($11.5 million and $11.1 million, respectively).

Donor-restricted endowed gifts require that the original corpus of the gifts be maintained in perpetuity. The distributions from earnings generated by these gifts may be either expended or added to principal, in accordance with donor restrictions and gift policies.

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

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

Tuition discounts are recorded to the extent that either institutional financial aid or aid funded by gifts, endowment earnings, and research activities are awarded. Tuition discounts attributable to institutional funds in 2011 and 2010 were $128.2 million and $121.9 million, respectively. Tuition discounts attributable to restricted gifts, endowment earnings, and research activities in 2011 and 2010 were $22.6 million and $21.6 million, respectively.

**Cash and Cash Equivalents and Operating Investments**

Cash equivalents include investments with original maturities of three months or less and all assets invested in the University's short-term investment fund, which the University utilizes to fund daily cash needs. The fund currently invests in short-term Treasury securities and other short-term, highly-liquid investments, all of which can be liquidated within 7 days. All investments held in the fund must be rated A3/A-1 or better by Moody's Investor Service or A-/P-1 by Standard & Poors at the time of purchase. The fund is expected to generate a return approximating or exceeding the 3-month Treasury bill rate. Approximately $49.1 million and $127.0 million of cash equivalents represent unspent bond proceeds and are reflected in the Consolidated Balance Sheets as deposits with bond trustees as of June 30, 2011 and 2010, respectively. Cash and cash equivalents that are part of endowment investments are shown therewith as these funds are not used for operating needs.

Operating investments primarily include obligations of the U.S. government and government agencies, bank certificates, commercial paper, corporate notes, and other fixed income obligations. Operating investments are reported at fair value, generally based on quoted market prices, and are used for general operating purposes.

**Securities Lending**

Through an agreement with its primary investment custodian, the University makes available its securities for loan to borrowers identified by the custodian. Collateral posted by the borrower for the benefit of the University is generally limited to cash, government securities, and irrevocable letters of credit. Both the custodian and the borrower have the right to terminate a loan at any time. In exchange for lending a security, the University receives a fee and continues earning applicable interest and dividends on the loaned security. As of June 30, 2011 and 2010, the University held $101.9 million and $90.0 million, respectively, of cash and cash equivalents as collateral deposits for securities on loan. Collateral held by the University is shown as an asset, and the obligation to return the collateral when the loan is terminated is presented as a liability in the Consolidated Balance Sheets. The total securities on loan had an estimated fair value of $99.0 million and $87.0 million at June 30, 2011 and 2010, respectively. Subsequent to June 30, 2011, the University terminated its securities lending program.

**Deposits with Bond Trustees**

Deposits with bond trustees consist of unspent bond proceeds which will be used for construction of certain facilities. These funds are invested in cash, cash equivalents, and Treasury securities and are reported in the Consolidated Balance Sheets at fair value.

**Endowment Investments**

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

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

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

**Derivative Financial Instruments**

The University records derivatives at fair value with changes in fair value reflected in the Consolidated Statements of Activities (see Note 9).

**Contributions**

The University records unconditional promises to give (which are agreements with donors involving nonreciprocal transfers of cash, other assets, or services) as either temporarily restricted or permanently restricted dependent upon the nature of the donor-imposed restrictions. Gifts whose restrictions are met in the same fiscal year as receipt are combined and reported with unrestricted gifts.

Unconditional promises to give made to the University are for the support of various schools and programs, including endowments for programs, faculty salaries, scholarships, and the renovation and expansion of physical facilities.

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

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

**Investments in Foundations**

The University's investments in foundations include the Bradford Educational Foundation, the Johnstown Educational Foundation, and the UPG (University of Pittsburgh at Greensburg) Foundation (the foundations). The purpose of the foundations is to receive, administer, and distribute property exclusively for the benefit of each respective regional campus. Each foundation is governed by a board, with a majority of members being non-University employees. As such, the University does not exercise control of the foundations. However, due to the foundations being financially interrelated to the University, the University recognizes the net assets and its share of the annual change in net assets of the foundations.

**Property, Plant, and Equipment**

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

**Insurance Liabilities**

The University is self-insured through an agreement with UPMC to provide medical coverage for its employees. A liability for estimated incurred but unreported claims of $6.8 million and $5.6 million has been recorded at June 30, 2011 and 2010, respectively, based upon management's analysis of claims history. This liability is reflected in accrued payroll and related liabilities in the Consolidated Balance Sheets.

The University is also self-insured for certain other activities, including workers' compensation, unemployment compensation, and litigation reserves. Liabilities have been established for these programs based on third-party administrators' estimates using the University's historical loss experience. The self-insurance accrual is subject to periodic adjustment by the University based on actual loss experience factors. Liabilities for these other self-insured obligations aggregated $9.3 million and $13.2 million at June 30, 2011 and 2010, respectively, and are included in accrued payroll and related liabilities on the Consolidated Balance Sheets.

**Split-Interest Agreements**

Other liabilities include $9.2 million and $9.4 million at June 30, 2011 and 2010, respectively, for split-interest agreements. These agreements with donors consist primarily of charitable gift annuities, pooled income funds, and irrevocable charitable remainder trusts for which the University serves as trustee. Assets are invested and payments are made to donors and/or other beneficiaries in accordance with the respective agreements.

**Research**

The University conducts sponsored research and development with various sponsors including agencies and departments of the federal government, the commonwealth, local government entities, companies, and foundations. Sponsored research activity in 2011 and 2010 was $801.2 million and $737.0 million, respectively, with approximately 64% of the funding awarded through the National Institutes of Health. Research grants and contracts - ARRA represents funding received through the American Recovery and Reinvestment Act of 2009. Most University research activity is incurred on a cost reimbursable basis with the University receiving funding after the related expenses have been incurred. Certain sponsors, however, provide research funding in advance of related expenses, and such funding is recorded as advanced receipt of sponsored research funds on the Consolidated Balance Sheets. Revenue on research awards is recognized as the related expenses are incurred.

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

**Estimates**

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

**Allowances for Doubtful Accounts**

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

**Tax-Exempt Status**

The University is exempt from federal income tax under Section 501(c)(3) of the United States Internal Revenue Code. Accordingly, no provision for income taxes has been reflected in the consolidated financial statements.

**New Accounting Standard**

In January 2010, the FASB issued Accounting Standards Update No. 2010-06, *Fair Value Measurements and Disclosures: Improving Disclosures About Fair Value Measurements* (ASU 2010-06). This standard requires disclosures regarding significant transfers in and out of Level 1 and Level 2 inputs. The ASU also clarifies existing disclosures for each class of assets and liabilities, as well as the valuation techniques and inputs used to measure fair value for Level 2 or Level 3 inputs. This standard was adopted by the University in 2011 (see Note 5).

## NOTE 2: ACCOUNTS AND NOTES RECEIVABLE, NET

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

| | 2011 | 2010 |
|---|---|---|
| | *(in thousands of dollars)* | |
| Sponsored research receivables, net of allowance for doubtful accounts of $1,240 in 2011 and $1,280 in 2010 | $ 91,012 | $ 91,551 |
| Plant construction receivables due from commonwealth | 22,696 | 17,829 |
| Hospitals and affiliated organizations receivables, net of allowance for doubtful accounts of $945 in 2011 and 2010 | 13,752 | 11,429 |
| Student receivables, net of allowance for doubtful accounts of $1,799 in 2011 and 2010 | 10,628 | 8,748 |
| Interest income receivables | 3,076 | 2,973 |
| Other receivables, net of allowance for doubtful accounts of $40 in 2011 and $193 in 2010 | 13,024 | 20,730 |
| **Total accounts and notes receivable, net** | $ 154,188 | $ 153,260 |

## Note 3: Contributions Receivable, Net

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

| | 2011 | 2010 |
|---|---|---|
| | *(in thousands of dollars)* | |
| Amounts due in: | | |
| Less than one year | $ 21,256 | $ 22,648 |
| One to five years | 32,219 | 35,654 |
| Greater than five years | 2,595 | 6,497 |
| Gross contributions receivable | 56,070 | 64,799 |
| Less: | | |
| Allowance for uncollectibles | (2,140) | (6,662) |
| Unamortized discounts | (1,648) | (3,174) |
| **Total contributions receivable, net** | $ 52,282 | $ 54,963 |

The current yields for one-year to 10-year U.S. Treasury notes are used to discount contributions receivable. Outstanding conditional promises to give to the University total $1.3 million and $3.7 million at June 30, 2011 and 2010, respectively, which are dependent upon the fulfillment of certain conditions and, therefore, are not included in the consolidated financial statements.

At June 30, 2011 and 2010, the five largest outstanding pledge balances represented 54.0% and 67.3%, respectively, of the University's net contributions receivable.

The University has been named as beneficiary in the wills of numerous donors totaling $106.1 million and $87.6 million at June 30, 2011 and 2010, respectively. These bequests are considered to be intentions to give and, therefore, are not included in the consolidated financial statements.

NOTE 4: INVESTMENTS

Investments at June 30 consist of the following:

| | 2011 | 2010 |
|---|---|---|
| | *(in thousands of dollars)* | |
| Endowment investments: | | |
| Pooled | $ 2,518,579 | $ 2,024,149 |
| Nonpooled | 26,513 | 23,875 |
| Subtotal endowment investments | 2,545,092 | 2,048,024 |
| Operating investments *(Note 1)* | 621,599 | 588,295 |
| **Total investments** | $ 3,166,691 | $ 2,636,319 |
| | | |
| Composition of endowment investments: | | |
| Cash and cash equivalents | $ 34,059 | $ 32,131 |
| Domestic equities | 331,998 | 279,102 |
| International equities | 474,501 | 399,581 |
| U.S. government and government agencies' securities, bank acceptances and certificates, and commercial paper | 163,061 | 114,361 |
| Corporate bonds and other obligations | 125,293 | 100,017 |
| Alternative investment funds and partnerships: | | |
| Marketable alternatives | 457,927 | 338,831 |
| Private equities/venture capital | 552,904 | 407,779 |
| Real assets | 405,349 | 341,372 |
| Other *(Westridge - see Note 14)* | - | 34,850 |
| **Total endowment investments** | $ 2,545,092 | $ 2,048,024 |
| | | |
| Composition of operating investments: | | |
| U.S. government and government agencies' securities, bank acceptances and certificates, and commercial paper | $ 419,237 | $ 504,884 |
| Corporate bonds and other obligations | 188,524 | 70,038 |
| Other | 13,838 | 13,373 |
| **Total operating investments** | $ 621,599 | $ 588,295 |

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

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

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

The following table summarizes the University's investments at June 30, 2011 and 2010 for which NAV was used as a practical expedient to estimate fair value.

| Asset Class/Investment Description | Fair Value Determined using NAV 2011 | Fair Value Determined using NAV 2010 | Unfunded Commitments at June 30, 2011 | Unfunded Commitments at June 30, 2010 |
|---|---|---|---|---|
| | *(in thousands of dollars)* | | | |
| Domestic equities | | | | |
| Long/short domestic equity fund | $ - | $ 47,804 | $ - | $ - |
| Emerging markets equities | | | | |
| Commingled emerging markets fund | 93,871 | 53,535 | - | - |
| Fixed income | | | | |
| High yield debt - redeemable | - | 8,585 | - | - |
| Marketable alternatives | | | | |
| Distressed debt - redeemable | 41,343 | 38,982 | - | - |
| Distressed debt - nonredeemable | 81,975 | 80,566 | - | 4,000 |
| Multi-strategy/arbitrage | 133,156 | 89,231 | - | - |
| Long/short equity | 201,453 | 130,052 | - | - |
| Total marketable alternatives | 457,927 | 338,831 | - | 4,000 |
| Nonmarketable alternatives | | | | |
| Private equity funds | 322,238 | 255,866 | 177,958 | 192,742 |
| Venture capital funds | 230,666 | 151,913 | 97,625 | 102,937 |
| Total nonmarketable alternatives | 552,904 | 407,779 | 275,583 | 295,679 |
| Real assets | | | | |
| Real assets - redeemable | 49,506 | 50,173 | - | - |
| Private real estate funds | 155,357 | 110,741 | 73,402 | 97,814 |
| Private energy funds | 149,048 | 126,565 | 61,314 | 50,467 |
| Private timber funds | 51,438 | 53,893 | 3,978 | 3,978 |
| Total real assets | 405,349 | 341,372 | 138,694 | 152,259 |
| **Total** | $ 1,510,051 | $ 1,197,906 | $ 414,277 | $ 451,938 |

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

**Long/Short Domestic Equity Fund**
The University's investment is an interest in a commingled fund that is fully redeemable without penalty as of any quarter-end with 60-day notice. The fund holds both long and short positions of publicly traded common equities. The University fully redeemed this investment in 2011.

**Commingled Emerging Markets Fund**
The University's investment is in a commingled fund that holds publicly traded emerging market equities. The investment may be liquidated without penalty within 120 days of providing a month-end notice. At the start of the fiscal year, the University was also invested in a separate, small-cap focused commingled fund managed by the same investment manager. The small-cap investment was fully redeemed in 2011.

**High Yield Debt – Redeemable**
The University's investment is an interest in a commingled fund that is fully redeemable without penalty at any month-end with 10-day notice. The fund holds publicly traded high yield debt and bank loans. The University fully redeemed this investment in 2011.

**Distressed Debt – Redeemable**
The University's investments are in two commingled funds. Both funds are hedge funds that hold both long and short positions in mostly publicly traded, and some privately traded, distressed debt securities (i.e., the securities trade at significant discounts to their par value). The University's interest in one of the funds is redeemable without penalty on a quarterly basis with 90-day notice beginning April 1, 2012. The University's interest in the other fund may be redeemed without penalty in annual 25% increments over the next four years.

**Distressed Debt – Nonredeemable**
The University's investments are interests in a total of nine commingled funds managed by three different investment managers. All of the funds hold distressed securities traded publicly and/or privately, and all have investment periods of three years or longer, during which committed capital may be called. The University's interests in the funds are reduced typically over multi-year periods as the managers return invested capital and distribute proceeds realized from underlying fund assets.

**Multi-Strategy/Arbitrage**
The University's investments are interests in five commingled funds. These funds are hedge funds that hold both long and short positions in equities, fixed income, and financial derivatives. The University's interests in four of the funds may be liquidated without penalty as follows: (a) two on an annual basis with 45-day notice; (b) one on an annual basis with 30-day notice, beginning March 31, 2012; and (c) one on an annual basis with 65-day notice beginning September 30, 2012. One-half of the University's interest in the fifth fund may be liquidated without penalty on a quarterly basis with 30-day notice. The other half of the University's interest in the fund is under a 2-year lock-up that ends on June 30, 2012; thereafter, it can be liquidated quarterly without penalty.

**Long/Short Equity**
The University's investments are interests in nine commingled funds. These funds are hedge funds that hold both long and short positions in publicly traded global equities. The University's interests in all but two of the funds may be liquidated without penalty on a quarterly or monthly basis with 30-45 day notice. Another fund can be liquidated quarterly with 180-day notice. The University's interest in the other fund is redeemable without penalty with 60-day notice every three years for 80% of the assets, on an annual basis for 10% of the assets, and on a quarterly basis for the remaining 10% of the assets.

**Private Equity Funds**
The University's investments are interests in 60 commingled funds. These funds are private equity funds that are invested in equity and equity-like securities of mostly nonpublicly traded companies over periods of typically three to five years, during which committed capital may be called. The University's interests in private equity funds are considered to be relatively illiquid in that they are not easily transferrable and typically achieve liquidity over multi-year periods when and if the fund managers return invested capital or distribute proceeds realized from underlying fund assets.

**Venture Capital Funds**
The University's investments are interests in 48 commingled funds. These funds are venture capital funds, a specialized type of private equity, and are invested in equity and equity-like securities of mostly nonpublicly traded, immature companies over periods of typically three to five years, during which committed capital may be called. The University's interests in venture capital funds are considered to be illiquid in that they are in riskier assets, they are not easily transferrable, and they typically can only achieve liquidity over multi-year periods when and if the fund managers return invested capital or distribute proceeds from the underlying fund assets.

**Real Assets - Redeemable**
The University's investments are interests in two commingled funds. These funds hold publicly traded physical assets, as well as financial assets associated with such physical assets, including real estate, natural resources,

commodities, and the global equities of hard asset companies. The University's interest in one of the funds is currently being liquidated; its interest in the other fund is fully redeemable without penalty on a monthly basis with 10 days notice.

**Private Real Estate Funds**
The University's investments are interests in 26 commingled funds. These funds are private real estate funds that are primarily invested in privately traded real estate-related properties and interests, including interests in companies engaged in real estate operations. These funds are invested over periods of typically three to five years, during which committed capital may be called. The University's interests in private real estate funds are considered to be relatively illiquid in that they are not easily transferrable and typically achieve liquidity over multi-year periods when and if the fund managers return invested capital or distribute proceeds realized from underlying fund assets.

**Private Energy Funds**
The University's investments are interests in 25 commingled funds. These funds are private energy funds that are primarily invested in privately traded energy-related properties and interests, including interests in oil and gas and other fossil fuel reserves, production, storage, and transportation facilities, power generating plants, and companies engaged in energy-related activities. These funds are invested over periods of typically three to five years, during which committed capital may be called. The University's interests in private energy funds are considered to be relatively illiquid in that they are not easily transferrable and typically achieve liquidity over multi-year periods when and if the fund managers return invested capital or distribute proceeds realized from underlying fund assets.

**Private Timber Funds**
The University's investments are interests in four commingled funds. These funds are private timber funds that are primarily invested in privately traded timber properties and interests, including interests in companies that acquire, manage, and sell timberland. These funds are invested over periods of typically three to five years, during which committed capital may be called. The University's interests in private timber funds are considered to be relatively illiquid in that they are not easily transferrable and typically achieve liquidity over extended, multi-year periods as the fund managers return invested capital or distribute proceeds realized from underlying fund assets.

## Note 5: Fair Value Measurements

Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures,* establishes a single authoritative definition of fair value, sets a framework for measuring fair value, and requires additional disclosures about fair value measurements. In accordance with ASC 820, fair value is defined as the price that the University would receive upon selling an asset or the price paid to transfer a liability (exit price) in an orderly transaction between market participants in the principal or, in the absence of a principal market, most advantageous market at the measurement date.

The principal market is the market in which the reporting entity would sell the asset or transfer the liability with the greatest volume and level of activity for the asset or liability. The most advantageous market is the market in which the reporting entity would maximize the amount received for an asset or minimize the amount paid to transfer a liability.

ASC 820 establishes a three-tier hierarchy, based on inputs to fair value measurements for disclosure purposes. Inputs may be observable or unobservable and refer broadly to the assumptions that market participants would use in pricing an asset or liability, including assumptions about risk.

The three-tier hierarchy of inputs is summarized in the three broad levels below:

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets that the University has the ability to access at the measurement date. This level of the fair value hierarchy provides the most reliable evidence of fair value and is used to measure fair value whenever available. Instruments valued by Level 1 measures primarily consist of directly held securities that are actively traded in public markets.

- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. These inputs include quoted prices for similar investments in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable; and inputs that are derived from observable market data by correlation or other means. Instruments valued by Level 2 measures include University holdings in certain structured debt obligations, University interests in certain commingled investment funds, interest rate swap agreements, and other thinly-traded instruments.

- Level 3 - Inputs that are unobservable for the asset or liability that are used to measure fair value when observable inputs are not available. These are inputs that are developed based on the best information available in the circumstances, which might include the University's own data. Instruments valued by Level 3 measures primarily include University interests in certain commingled funds. Fair value for these interests is estimated based on the reported NAV per share or its equivalent of the fund in which the University is invested.

University fund investments for which NAV is used as a practical expedient to estimate fair value are classified as either Level 2 or 3 assets in the fair value hierarchy, depending on the fair value tier in which the underlying fund assets would fall and the University's ability to redeem its interest in the fund. If the underlying fund assets are publicly traded securities for which there exists a broad, active market, and the University's interest can be redeemed without penalty within the near term, the University's interest in the fund is classified as a Level 2 investment. If the underlying fund assets are privately traded and/or the University's interest cannot be redeemed without penalty (generally within 90 days of June 30), the University's interest in the fund is classified as a Level 3 investment.

When observable prices are not available, the investments are valued using one or more of the following valuation techniques: market approach - this approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities; income approach - this approach determines a valuation by discounting future cash flows; or cost approach - this approach is based on the principle of substitution and the concept that a market participant would not pay more than the amount that would currently be required to replace the asset. These valuation techniques may include inputs such as price information, volatility statistics, operating statistics, specific and broad credit data, recent transactions, earnings forecasts, discount rates, reserve reports, futures pricing, and other factors. The classification of investments in the fair value hierarchy is not necessarily an indication of the risks, liquidity, or degree of difficulty in determining fair value.

The following table summarizes the inputs used at June 30, 2011 in valuing the University assets and liabilities carried at fair value:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| | *(in thousands of dollars)* | | | |
| Assets | | | | |
| Endowment investments: | | | | |
| Cash and cash equivalents | $ 26,611 | $ 7,448 | $ - | $ 34,059 |
| Domestic equities | 311,636 | 20,362 | - | 331,998 |
| International equities | 368,010 | 94,407 | 12,084 | 474,501 |
| U.S. government, corporate bonds, and other obligations | 230,624 | 54,632 | 3,098 | 288,354 |
| Marketable alternatives | - | 153,577 | 304,350 | 457,927 |
| Private equities/venture capital | - | - | 552,904 | 552,904 |
| Real assets | - | 48,289 | 357,060 | 405,349 |
| Operating investments: | | | | |
| U.S. government, corporate bonds, and other obligations | 541,753 | 66,008 | - | 607,761 |
| Other | 1,082 | - | 12,756 | 13,838 |
| Deposits with bond trustees | 43,782 | 5,362 | - | 49,144 |
| **Total assets** | $ 1,523,498 | $ 450,085 | $ 1,242,252 | $ 3,215,835 |
| Liabilities | | | | |
| **Interest rate swaps** | $ - | $ 47,498 | $ - | $ 47,498 |

The following table summarizes the inputs used at June 30, 2010 in valuing the University assets and liabilities carried at fair value:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| | *(in thousands of dollars)* | | | |
| Assets | | | | |
| Endowment investments: | | | | |
| Cash and cash equivalents | $ 23,802 | $ 8,329 | $ - | $ 32,131 |
| Domestic equities | 188,353 | 90,749 | - | 279,102 |
| International equities | 335,165 | 54,318 | 10,098 | 399,581 |
| U.S. government, corporate bonds, and other obligations | 145,419 | 58,164 | 10,795 | 214,378 |
| Marketable alternatives | - | 128,805 | 210,026 | 338,831 |
| Private equities/venture capital | - | - | 407,779 | 407,779 |
| Real assets | - | 48,735 | 292,637 | 341,372 |
| Other | - | - | 34,850 | 34,850 |
| Operating investments: | | | | |
| U.S. government, corporate bonds, and other obligations | 545,449 | 29,473 | - | 574,922 |
| Other | 792 | - | 12,581 | 13,373 |
| Deposits with bond trustees | 92,163 | 34,836 | - | 126,999 |
| **Total assets** | $ 1,331,143 | $ 453,409 | $ 978,766 | $ 2,763,318 |
| Liabilities | | | | |
| **Interest rate swaps** | $ - | $ 60,927 | $ - | $ 60,927 |

The following tables summarize the change in the Level 3 activity for the years ended June 30, 2011 and 2010:

| | 2011 (in thousands of dollars) | | | | | | |
|---|---|---|---|---|---|---|---|
| | International Equities | U.S. Government Corporate and Other | Marketable Alternatives | Real Assets | Private Equities | Other | Total |
| Balance - June 30, 2010 | $ 10,098 | $ 10,795 | $ 210,026 | $ 292,637 | $ 407,779 | $ 47,431 | $ 978,766 |
| Capital calls/purchases | 4,474 | 1,951 | 82,000 | 74,330 | 87,300 | 726 | 250,781 |
| Distributions/sales | (5,188) | (10,117) | (19,590) | (55,797) | (78,463) | (45,815) | (214,970) |
| Realized gains | 588 | 739 | - | - | - | 9,590 | 10,917 |
| Unrealized gains (losses) | 2,112 | (270) | 31,914 | 45,890 | 136,288 | 824 | 216,758 |
| **Balance - June 30, 2011** | $ 12,084 | $ 3,098 | $ 304,350 | $ 357,060 | $ 552,904 | $ 12,756 | $1,242,252 |

| | 2010 (in thousands of dollars) | | | | | | |
|---|---|---|---|---|---|---|---|
| | International Equities | U.S. Government Corporate and Other | Marketable Alternatives | Real Assets | Private Equities | Other | Total |
| Balance - June 30, 2009 | $ 14,816 | $ 4,325 | $ 241,272 | $ 269,121 | $ 326,758 | $ 46,366 | $ 902,658 |
| Capital calls/purchases | 6,530 | 6,344 | 22,698 | 48,312 | 68,960 | 1,203 | 154,047 |
| Distributions/sales | (14,047) | (296) | (45,488) | (26,545) | (31,566) | (215) | (118,157) |
| Transfers out | - | - | (55,650) | - | - | - | (55,650) |
| Realized gains | 586 | - | - | - | - | - | 586 |
| Unrealized gains | 2,213 | 422 | 47,194 | 1,749 | 43,627 | 77 | 95,282 |
| **Balance - June 30, 2010** | $ 10,098 | $ 10,795 | $ 210,026 | $ 292,637 | $ 407,779 | $ 47,431 | $ 978,766 |

Gains and losses (realized and unrealized) for Level 3 activity are reported in other activities in the Consolidated Statements of Activities. The unrealized gains related to investments held at June 30, 2011 and 2010 were $217.9 million and $95.3 million, respectively.

For the year ended June 30, 2011, the University did not have any transfers between fair value levels 1, 2, and 3.

## Note 6: Property, Plant, and Equipment, Net

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

| | 2011 | 2010 |
|---|---|---|
| | *(in thousands of dollars)* | |
| Land | $ 51,255 | $ 51,255 |
| Buildings and improvements | 2,366,353 | 2,127,243 |
| Equipment | 622,991 | 578,005 |
| Library books | 227,176 | 216,969 |
| Works of art, historical treasures, and similar assets | 14,770 | 14,668 |
| Construction in progress | 180,354 | 263,879 |
| Subtotal | 3,462,899 | 3,252,019 |
| Less: Accumulated depreciation | (1,788,142) | (1,670,586) |
| **Total property, plant, and equipment, net** | $ 1,674,757 | $ 1,581,433 |

In 2011, the University expended $229.2 million for property, plant, and equipment, of which $33.9 million was funded by the commonwealth. Significant additions included $32.3 million for operating equipment; $17.8 million for continued renovations to the Chevron Science Center; $16.1 million for renovations to Benedum Hall; $14.2 million for renovations to the Biomedical Science Tower; $13.7 million for the Petersen Sports Complex; $12.8 million for the expansion of Bouquet Gardens; $10.2 million for library acquisitions; $6.1 million for renovations to Parran and Crabtree Halls; $5.3 million for the Johnstown Campus Wellness Center; $5.2 million for renovations to the O'Hara Student Center (formerly Concordia Club); $5.0 million for the Salk Hall addition; $3.4 million for the Mid-Campus Complex renovations; $3.2 million for the renovation of Fisher Hall at the Bradford Campus; $3.0 million for a new research lab in Eberly Hall; and $2.2 million for the Posvar Hall generator.

In 2010, the University expended $195.2 million for property, plant, and equipment, of which $36.1 million was funded by the commonwealth. Significant additions included $31.7 million for renovations to Benedum Hall; $30.6 million for operating equipment; $17.4 million for the Petersen Sports Complex; $12.3 million for renovations to the Chevron Science Center; $10.6 million for library acquisitions; $6.8 million for renovations at the Falk School; $4.2 million for the Johnstown Campus Wellness Center; $3.8 million for construction of a new dorm at the Bradford Campus; $3.0 million for the Salk Hall addition; $2.9 million for renovations to the University Club; $2.2 million for renovations of Fisher Hall at the Bradford Campus; $2.1 million for renovations to 7500 Thomas Boulevard; $2.1 million for the South Loop Steam distribution; and $2.0 million for the Allen Hall Mid-Campus emergency research generator.

The amount capitalized in property, plant, and equipment related to expenditures funded by the commonwealth on behalf of the University totaled $501.7 million and $439.5 million at June 30, 2011 and 2010, respectively. Formal title to this property passes to the University upon completion of each project. The net book value of these items was $231.6 million and $184.3 million at June 30, 2011 and 2010, respectively.

## NOTE 7: CONDITIONAL ASSET REMEDIATION OBLIGATION

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

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

| | 2011 | 2010 |
|---|---|---|
| | *(in thousands of dollars)* | |
| Balance - beginning of year | $ 40,303 | $ 37,107 |
| Accretion/ change in assumptions | 1,659 | 4,873 |
| Liabilities settled | (1,103) | (1,677) |
| **Balance - end of year** | $ 40,859 | $ 40,303 |

| | Range of Years Remaining to Maturity | 2011 Effective Interest Rates | Outstanding Principal (in thousands of dollars) 2011 | 2010 |
|---|---|---|---|---|
| Variable-rate bonds: | | | | |
| Series 2007-B Bonds | 29-30 | 0.23%-0.32% | $ 44,621 | $ 44,621 |
| Series 2005-B Bonds | 20-27 | 0.18%-0.37% | 45,000 | 45,000 |
| Series 2005-C Bonds | 21-24 | 0.25%-0.33% | 30,000 | 30,000 |
| Total variable-rate bonds | | | 119,621 | 119,621 |
| Term-rate bonds: | | | | |
| Series 2005-A Bonds | 26-28 | 5.00% | 40,000 | 40,000 |
| Series 2002-B Bonds | 20-25 | 5.00% | 15,000 | 15,000 |
| Total term-rate bonds | | | 55,000 | 55,000 |
| Fixed-rate bonds and notes payable: | | | | |
| Series 2009-A/B Bonds | 0-20 | 1.76%-5.10% | 410,640 | 428,520 |
| Series 2007-B Bonds | 12-17 | 4.28%-4.69% | 60,000 | 60,000 |
| Series 2005-A Bonds | 17-19 | 4.69%-4.83% | 35,000 | 35,000 |
| Series 2002-A Bonds | 0-12 | 1.93%-4.31% | 40,000 | 40,000 |
| Series 2002-B Bonds | 15-16 | 4.53%-4.74% | 14,500 | 14,500 |
| Series 2000-A/B/C Bonds | 2-24 | 4.00%-5.07% | 154,800 | 154,800 |
| Series 2011 PANTHER Notes, due June 18, 2012 | | 0.32% | 114,000 | - |
| Series 2010 PANTHER Notes, due May 31, 2011 | | 0.47% | - | 118,000 |
| Series 2007 PANTHER Notes, due August 1, 2010 | | 3.85% | - | 118,000 |
| Noninterest-bearing promissory note | | | 171 | 171 |
| Total fixed-rate bonds and notes payable | | | 829,111 | 968,991 |
| Unamortized premium | | | 28,866 | 37,588 |
| **Total bonds and notes payable** | | | **$ 1,032,598** | **$ 1,181,200** |

Interest costs incurred in 2011 and 2010 were $45.9 million and $55.3 million, respectively. Included in these amounts is capitalized interest associated with various construction projects. Capitalized interest for 2011 and 2010 was $3.6 million and $4.4 million, respectively.

Liquidity support for the $119.6 million of outstanding variable-rate demand bonds (VRDBs) in commercial paper (CP) mode is provided by the University. In the event the University receives notice of an optional tender on its VRDBs in CP mode, the purchase price of the bonds will be paid from the remarketing of such bonds. However, if the remarketing proceeds are insufficient, the University will have a current obligation to purchase the tendered bonds. To provide a secondary source of liquidity for this type of event, the University entered into a $100.0 million unsecured standby liquidity agreement with a financial institution that matures in September 2013. Since the October 2009 effective date of the liquidity agreement, no draws have occurred.

In May 2011, the Univesity issued its Pitt Asset Notes - Tax Exempt Higher Education Series 2011 (PANTHERS of 2011) in the amount of $114.0 million. Of this amount, $96.0 million was used to partially refund the $118.0 million of PANTHERS of 2010 that matured on May 31, 2011, and $18.0 million was used for equipment expenditures. The PANTHERS of 2011 mature on June 18, 2012.

The PANTHERS of 2010 were issued in May 2010 in the amount of $118.0 million. Of this amount, $78.0 million was used to partially refund the $118.0 million of PANTHERS of 2007 that matured on August 1, 2010, and $40.0 million was used for equipment expenditures.

The fair value (as determined primarily by quoted market prices) of total bonds and notes payable was $1,114.4 million and $1,264.5 million at June 30, 2011 and 2010, respectively.

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

| | |
|---|---|
| 2012 | $ 131.5 |
| 2013 | $ 30.0 |
| 2014 | $ 30.4 |
| 2015 | $ 35.0 |
| 2016 | $ 30.5 |

The foregoing does not include $119.6 million of VRDBs in CP mode, all of which have final maturity dates between 2035 and 2041. These bonds bear short-term rates that are fixed over staggered periods of approximately 90 days each and are remarketed at the expiry of each rate period.

The University had three general unsecured credit facilities, aggregating $175.0 million, at June 30, 2010. These 364-day facilities were renewed in 2011 with an aggregate available amount of $125.0 million. No draws were made under the facilities during 2011 or 2010. Although each of the three credit facilities carry an expiry date of October 28, 2011, it is management's intention to extend each facility for another 364-day term.

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

Derivative instruments are carried at fair value and included in the Consolidated Balance Sheets. Gains and losses from derivative instruments are reported in other activities in the Consolidated Statements of Activities. The University may be exposed to financial loss should a derivative counterparty fail to perform pursuant to the instrument. In the case of exchange-traded derivatives, the counterparty is the exchange itself. In the case of "over-the-counter" derivatives, the counterparty is typically a financial institution. Counterparty risks are mitigated by using creditworthy counterparties, settling positions periodically, and requiring collateral to be posted at predetermined levels of exposure.

Not including University derivative instruments held by various alternative investment funds, University financial assets invested in derivative instruments had a fair value of $83.9 million and $136.7 million at June 30, 2011 and 2010, respectively, which are included in endowment investments on the Consolidated Balance Sheets.

The University liabilities arising from variable-to-fixed interest rate swap agreements associated with certain University debt obligations had an aggregated fair value of $47.5 million and $60.9 million at June 30, 2011 and 2010, respectively, and are included in other liabilities on the Consolidated Balance Sheets. The fair value represents the estimated amount the University would be required to pay to terminate these agreements as of the respective fiscal year end. The University recorded in the Consolidated Statements of Activities an unrealized gain of $13.4 million in 2011 and an unrealized loss of $5.2 million in 2010 due to changes in fair value of the swaps.

The aggregate notional amount of the swap agreements associated with University debt was $430.7 million and $448.6 million at June 30, 2011 and 2010, respectively. These swaps were entered into for the sole purpose of hedging the interest payable on the University's Series 2000, 2002, 2005, and 2007 VRDBs. As such, the notional amounts and maturity dates of the swap agreements precisely matched the VRDBs they were intended to hedge at the time the agreements were executed. As the VRDBs were subsequently modified or refinanced, the University terminated or amended various swap agreements in 2010 to achieve closer alignment with the current debt obligations. The variable interest rates received by the University under the swap agreements are either 67% or 70% of one- or three-month LIBOR, while the fixed rates paid by the University range from 3.24% to 5.14%. Net swap payments made or received by the University are reported in interest expense in the Consolidated Statements of Activities. No collateral was called or posted during 2011 with respect to these swap agreements. Furthermore, the University does not anticipate ever posting collateral pursuant to these swap agreements since the collateral thresholds applicable to the University are infinite at the University's current credit ratings.

NOTE 10: PENSION AND POSTRETIREMENT OBLIGATIONS

**Pension**
The University provides retirement benefits under contributory or noncontributory plans to substantially all employees. The University's contributory plan provides for participation in the Teachers Insurance and Annuity Association (TIAA) and College Retirement Equities Fund (CREF) and in investment funds of the Vanguard Group. The plan is fully funded and requires three years of service for vesting of the University contribution. Employees hired before January 1, 1995 were immediately vested. University contributions to this plan in 2011 and 2010 were $68.9 million and $66.2 million, respectively.

The noncontributory plan is a defined benefit pension plan that covers employees who do not participate in the contributory plan. The plan provides for vesting after five years with pension benefits accruing at 2.1% of base salary or the Social Security wage base, whichever is lower. Pension benefits are payable upon normal retirement at age 65 or early retirement at age 55, in accordance with the conditions and pension eligibility criteria described in the plan. University contributions to this plan in 2011 and 2010 were $3.0 million and $3.2 million, respectively.

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

Though funding is not required, the University has elected to fund the medical and life insurance portions of its postretirement liability via a quasi-endowment, which is managed by the University's external endowment fund managers. The fair value of these investments at June 30, 2011 and 2010 was $232.3 million and $178.9 million, respectively, and was included in endowment investments in the Consolidated Balance Sheets.

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

In 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act (collectively, the Health Care Acts) were signed into law. The Health Care Acts include several provisions that affect the University's postretirement benefit plans. The University has evaluated the effects of the Health Care Acts and concluded the following:

- The age 26 rule will have a minimal impact on postretirement medical costs due to the low number of retirees with adult dependents.

- The impact of the removal of annual and lifetime limits was reviewed and is expected to be negligible.

- The enactment of health care reform is expected to result in a reduction in federal subsidies to Medicare Advantage plans, which will cause an increase in employer/retiree costs. The University expects to make future plan design adjustments to mitigate the impact of any cost increases. Further, the University has certain cost caps in place which will lessen the impact of any subsidy reductions. Finally, a slight adjustment was made to the future trend rates to account for the subsidy reduction.

- Any revenues derived from the Early Retiree Reinsurance Program (EERP) are expected to be used towards reducing future increases in plan costs. However, the anticipated revenue is expected to be minimal when compared to overall costs.

- Projections indicate that the University will not be subject to the excise taxes on high cost plans.

The effect of the provisions, as detailed above, is estimated to be approximately $2.5 million. This amount has been included in the measurement of the postretirement benefit obligation as of June 30, 2011.

The University uses a measurement date of June 30 for plan assets and the benefit obligations. Information related to the benefit obligation, assets and funded status of the defined benefit pension plan and the postretirement benefit plan as of and for the years ended June 30, 2011 and 2010 is summarized in the table below:

| | Defined Benefit Plan | | Postretirement Plan | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| | *(in thousands of dollars)* | | | |
| **Net periodic benefit cost:** | | | | |
| Service cost | $ 3,085 | $ 2,915 | $ 12,077 | $ 14,058 |
| Interest cost | 3,156 | 3,181 | 16,433 | 18,027 |
| Expected return on plan assets | (3,251) | (2,915) | - | - |
| Actuarial loss | 246 | 217 | 1,204 | 1,280 |
| Amortization of transition obligation | - | - | 3,031 | 3,031 |
| Amortization of prior service credit | (224) | (224) | (3,965) | (3,965) |
| **Net periodic benefit cost** | $ 3,012 | $ 3,174 | $ 28,780 | $ 32,431 |
| **Funded status:** | | | | |
| Benefit obligation at beginning of year | $ 53,153 | $ 45,995 | $ 291,651 | $ 262,988 |
| Service cost | 3,085 | 2,915 | 12,077 | 14,058 |
| Interest cost | 3,156 | 3,181 | 16,433 | 18,027 |
| Actuarial loss (gain) | 1,150 | 1,613 | (11,224) | 6,669 |
| Benefits paid | (575) | (551) | (10,807) | (10,091) |
| **Benefit obligation at end of year** | $ 59,969 | $ 53,153 | $ 298,130 | $ 291,651 |
| Fair value of plan assets at beginning of year | $ 41,191 | $ 34,851 | $ - | $ - |
| Actual return on plan assets | 9,226 | 3,717 | - | - |
| Actual plan contributions | 3,012 | 3,174 | - | - |
| Benefits paid | (575) | (551) | - | - |
| **Fair value of plan assets at end of year** | $ 52,854 | $ 41,191 | $ - | $ - |
| **Funded status - liability recognized in Consolidated Balance Sheets:** | | | | |
| **Pension and postretirement obligations** | $ (7,115) | $ (11,962) | $ (298,130) | $ (291,651) |
| **Accumulated benefit obligation** | $ 57,461 | $ 50,899 | | |

Estimated 2012 employer contribution to the defined benefit plan: $ 2,728

| | Defined Benefit Plan | | Postretirement Plan | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| **Weighted-average assumptions used to determine the benefit obligation (liability) at June 30:** | | | | |
| Discount rate | 6.0% | 6.0% | 6.0% | 5.75% |
| Expected long-term return on plan assets | 8.0% | 8.0% | - | - |
| Rate of compensation increase: | | | | |
| 2011 | 2.5% | 2.5% | - | - |
| 2012 and thereafter | 3.0% | 3.0% | - | - |
| Assumed healthcare trend cost: | | | | |
| Initial trend - pre-age 65 retirees | - | - | 9.0% | 9.0% |
| Initial trend - post-age 65 retirees | - | - | 10.0% | 15.0% |
| Ultimate trend | - | - | 5.0% | 5.0% |
| Year to reach ultimate | - | - | 2017 | 2015 |
| **Weighted-average assumptions used to determine the net periodic cost (expense) for the years ended June 30:** | | | | |
| Discount Rate | 6.0% | 7.0% | 5.75% | 7.00% |
| Rate of compensation increase | 3.0% | 5.0% | - | - |
| Expected long-term return on plan assets | 8.0% | 8.5% | - | - |
| Assumed health care trend cost: | | | | |
| Initial trend - pre-age 65 retirees | - | - | 9.0% | 9.0% |
| Initial trend - post-age 65 retirees | - | - | 15.0% | 20.0% |
| Ultimate trend | - | - | 5.0% | 5.0% |
| Year to reach ultimate | - | - | 2015 | 2014 |

| **Estimated future benefit payments:** | Defined Benefit Plan | Postretirement Plan |
|---|---|---|
| | *(in thousands of dollars)* | |
| 2012 | $ 1,198 | $ 12,838 |
| 2013 | $ 1,315 | $ 14,743 |
| 2014 | $ 1,455 | $ 16,324 |
| 2015 | $ 1,624 | $ 18,179 |
| 2016 | $ 1,839 | $ 19,791 |
| 2017-2021 | $ 13,264 | $ 121,380 |

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

| | Increase | | (Decrease) | |
|---|---|---|---|---|
| | *(in millions of dollars)* | | | |
| | Revised Amount | Percent Change | Revised Amount | Percent Change |
| Service and interest cost (medical component only) | $ 28.9 | 11.6% | $ 23.0 | 11.3% |
| Total periodic benefit cost | $ 33.5 | 16.5% | $ 24.2 | 16.0% |
| Benefit obligation for healthcare benefits | $ 293.7 | 9.6% | $ 243.3 | 9.2% |
| Total benefit obligation | $ 323.8 | 8.6% | $ 273.7 | 8.2% |

**Pension Assets**
Assets related to the University's defined benefit pension plan are segregated in a trust and invested in a balanced fund managed by a third-party investment manager. The fair value of these assets at June 30, 2011 and 2010 was $52.9 million and $41.2 million, respectively. The fund is invested in domestic and international equities and fixed income securities using the S&P 500 Index as a benchmark for domestic equities, the MSCI EAFE Index for international equities, and the Barclays Intermediate Government/Credit Bond Index for the fixed income securities. The specific investment objective is to meet or exceed the investment policy benchmark over the long term.

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

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

| | Target Asset Allocation |
|---|---|
| Domestic equity | 35% |
| International equity | 35% |
| Fixed income | 30% |

The actual asset allocation as of June 30, 2011 and 2010 was 70% and 60%, respectively, for combined equities and 30% and 40%, respectively, for fixed income securities.

The fair value of the University's pension plan assets at June 30, by asset category, was as follows:

| | 2011 | 2010 |
|---|---|---|
| | *(in thousands of dollars)* | |
| | Level 2 | Level 2 |
| **Asset class** | | |
| Equity securities: | | |
| Stock index | $ 16,616 | $ 11,400 |
| Small cap | 1,871 | 1,362 |
| International | 18,501 | 11,793 |
| Debt securities | 12,559 | 12,662 |
| Cash and equivalents | 3,307 | 3,974 |
| **Total** | $ 52,854 | $ 41,191 |

GAAP provides information on the net asset classification of donor-restricted endowment funds for not-for-profit organizations that are subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA), including enhanced disclosures related to an organization's endowment funds regardless of whether the organization is located in a state that is subject to UPMIFA. The enhanced disclosures relate to net asset classification and changes in endowment net assets and have been incorporated in the tables below.

The commonwealth has not adopted UPMIFA and, instead, enacted in December 1998 Pennsylvania Act 141 (codified as Title 15 of the Pennsylvania Consolidated Statutes §5548(c) and referred to herein as "Title 15") to govern the investment of restricted funds held in trust by Pennsylvania nonprofit corporations. Title 15 permits Pennsylvania nonprofit corporations to elect a "total return" approach for determining income distributions from restricted funds held in trust, whereby "income" is defined as a stipulated percentage of the value of the assets held; the stipulated percent must be determined at least annually and may be no less than 2% nor more than 7%, and the value of the assets held must be averaged over a period of three or more preceding years. A resolution to elect a "total return" approach for determining endowment income distributions for the University's consolidated investment pool was passed by the University's Board of Trustees on October 21, 1999. The University's endowment income distribution is determined annually using a stipulated percentage of 4.25% of the endowment's three-year average fair value, provided that such distribution is not less than the amount distributed in the previous year. Nevertheless, instead of distributing the same amount in 2011 as was distributed for 2010, the Investment Committee of the Board of Trustees voted on June 10, 2010 to reduce the distribution amount for 2011 by approximately 5% due to the significant declines in endowment market value during the preceding three-year period. The resulting endowment income distribution amount for 2011 equaled approximately 4.68% of the endowment's three-year average fair value.

Employing the total return approach, the University records the original value of an endowed gift as a permanently restricted asset, along with any endowment income distributions that are returned to principal. Nonendowed funds that lack third party donor restrictions but function as endowments (quasi-endowments) are classified as unrestricted net assets. Gains and losses attributable to donor-restricted endowed funds are recorded as temporarily restricted net assets, whereas gains and losses attributable to quasi-endowment funds are recorded as unrestricted net assets. Temporarily restricted net assets also include nonendowed gifts that are subject to third party donor restrictions with respect to purpose or time.

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

| | 2011 | | | |
|---|---|---|---|---|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
| | *(in thousands of dollars)* | | | |
| Donor-restricted endowment funds | $ - | $ 618,607 | $ 519,695 | $ 1,138,302 |
| Quasi-endowment funds | 1,369,918 | - | - | 1,369,918 |
| **Total endowment net assets** | $ 1,369,918 | $ 618,607 | $ 519,695 | $ 2,508,220 |

| | 2010 | | | |
|---|---|---|---|---|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
| | *(in thousands of dollars)* | | | |
| Donor-restricted endowment funds | $ - | $ 440,996 | $ 499,173 | $ 940,169 |
| Quasi-endowment funds | 1,079,802 | - | - | 1,079,802 |
| **Total endowment net assets** | $ 1,079,802 | $ 440,996 | $ 499,173 | $ 2,019,971 |

The change in endowment net assets for the years ended June 30 were as follows:

| | 2011 | | | |
|---|---|---|---|---|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
| | *(in thousands of dollars)* | | | |
| Endowment net assets - beginning of year | $ 1,079,802 | $ 440,996 | $ 499,173 | $ 2,019,971 |
| Endowment return: | | | | |
| Endowment earnings | 22,245 | - | 2,247 | 24,492 |
| Net gains | 286,932 | 177,611 | 165 | 464,708 |
| Total endowment return | 309,177 | 177,611 | 2,412 | 489,200 |
| Gifts | 664 | - | 18,110 | 18,774 |
| Net distributions | (77,529) | - | - | (77,529) |
| Net transfers | 57,804 | - | - | 57,804 |
| **Endowment net assets - end of year** | $ 1,369,918 | $ 618,607 | $ 519,695 | $ 2,508,220 |

| | 2010 | | | |
|---|---|---|---|---|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
| | *(in thousands of dollars)* | | | |
| Endowment net assets - beginning of year | $ 967,054 | $ 386,026 | $ 476,252 | $ 1,829,332 |
| Endowment return: | | | | |
| Endowment earnings | 15,498 | - | 1,642 | 17,140 |
| Net gains | 162,982 | 54,970 | - | 217,952 |
| Total endowment return | 178,480 | 54,970 | 1,642 | 235,092 |
| Gifts | 571 | - | 21,279 | 21,850 |
| Net distributions | (81,269) | - | - | (81,269) |
| Net transfers | 14,966 | - | - | 14,966 |
| **Endowment net assets - end of year** | $ 1,079,802 | $ 440,996 | $ 499,173 | $ 2,019,971 |

Nearly 99 percent of the University's endowment funds are collectively managed in a broadly diversified pool of assets called the consolidated investment pool. The Investment Committee of the Board of Trustees provides advice to University management, including the approval of endowment investment guidelines, objectives, and policies, and it is responsible for reviewing the selection of investment advisors and investment performance.

The asset allocation policy is established with the intent of optimizing long-term portfolio returns while minimizing market and manager risks. It reflects a desire for portfolio diversification by incorporating allocations across several broad asset classes, including: domestic equity, international equity, and emerging markets equity; fixed income; real assets; marketable alternatives; and nonmarketable alternatives.

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

## Note 12: Functional Expenses

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

| | 2011 | 2010 |
|---|---|---|
| | *(in thousands of dollars)* | |
| Instruction | $ 476,743 | $ 461,399 |
| Research | 664,815 | 607,123 |
| Public service | 98,865 | 97,690 |
| Academic support | 140,642 | 137,603 |
| Libraries | 50,229 | 51,897 |
| Student services | 123,648 | 114,830 |
| Institutional support | 173,682 | 168,435 |
| Auxiliary enterprises | 122,040 | 117,518 |
| **Total functional expenses** | $ 1,850,664 | $ 1,756,495 |

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

## Note 13: Related Parties

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

Certain University SOM faculty and staff provide clinical services through their University appointments to UPMC, UPP, and affiliated hospitals. The University invoices these entities monthly for reimbursement of the clinical portion of the associated compensation costs. SOM faculty members having both a University academic appointment and a separate, external appointment for clinical responsibilities participate in the common paymaster arrangement for purposes of determining appropriate FICA taxation. In addition to the reimbursable compensation costs, the University also engages in other transactions with these entities, which include providing certain facilities-related services, telephone, mailing, printing, and various other services, which are reimbursed at cost. Billings to UPMC, UPP, and affiliated hospitals for clinical compensation and other costs totaled $119.2 million and $117.9 million in 2011 and 2010, respectively.

In 1998, the University signed a 10-year agreement with UPMC that included financial commitments designed to further the two entities' commitment to their interrelated teaching, research, clinical care, and community service missions. As part of the agreement, UPMC provides $12.5 million annually in funding for the SOM. UPMC also provides additional funding up to $2.5 million annually on a matching basis. The match is on a one-to-two basis with UPMC matching $1 for every $2 provided by the University to support health sciences programs. The University has received this match each year since the inception of the agreement. This agreement was amended in 2007 under essentially the same terms, except for a provision to provide an additional $10.0 million per year in 2007, increased annually by $0.5 million from 2008 through 2016. The University received $27.0

million and $26.5 million (including the annual match) in 2011 and 2010, respectively. These amounts are reported as other revenue in the Consolidated Statements of Activities.

The agreement was further amended in 2009 to include additional financial support from UPMC through the Children's Hospital of Pittsburgh of UPMC (CHP) to the University of $7.5 million annually related to an agreement detailing the transfer of certain pediatric research programs from CHP to the University. This transfer standardized procedures, eliminated duplication of services, improved efficiency, reduced costs, and enhanced recruitment efforts for pediatric programs.

Additionally, UPMC provided support to various departments within the SOM to augment their operating budgets. These payments were made to those departments which do not generate sufficient revenues to meet their research and academic costs. Payments made by UPMC for this purpose totaled $7.5 million and $7.3 million in 2011 and 2010, respectively, and are reported as sales and services, educational and other, in the Consolidated Statements of Activities.

UPMC also provided $12.7 million and $12.3 million in 2011 and 2010, respectively, of contractual dean's tax, which represents additional support for the academic and research activities of the SOM. This activity is reported as sales and services, educational and other, in the Consolidated Statements of Activities.

The University is involved in certain rental arrangements where the University acts as both lessor or lessee with UPMC and its affiliates. Rental revenue from UPMC and affiliates totaled $9.8 million and $10.7 million in 2011 and 2010, respectively. Rent expense paid to UPMC and affiliates totaled $23.6 million and $22.6 million in 2011 and 2010, respectively.

UPMC serves as the provider of health insurance coverage to all eligible University employees who enroll in the plan. The University is self-insured for these costs and reimburses UPMC for actual claims cost. Health insurance expense including administrative fees totaled $97.1 million and $85.9 million in 2011 and 2010, respectively, and is reported as fringe benefit expense on the Consolidated Statements of Activities.

UPMC receives federal matching funds for costs incurred by academic medical centers for medical assistance services. The funds are remitted to the University to support the activities of the SOM, the Western Psychiatric Institute and Clinic (WPIC), the Center for Public Health Practice, and the clinic within the School of Dental Medicine. These remittances were $16.6 million and $17.4 million in 2011 and 2010, respectively, and are reported as commonwealth appropriation revenue in the Consolidated Statements of Activities.

In 2003, the University and UPMC created the Medical and Health Sciences Foundation (MHSF), a separate 501(c)(3) organization. The mission of MHSF is to create a unified fundraising organization for the University's schools of the health sciences and UPMC. The arrangement calls for the cost of MHSF to be split evenly between the University and UPMC. In 2011 and 2010, UPMC's share of total operating costs for MHSF totaled $3.9 million and $3.5 million, respectively, and is reported as other revenue in the Consolidated Statements of Activities. All gifts generated by MHSF are credited to the University or UPMC based upon donor intent.

In November 2004, the University entered into an agreement with UPMC to jointly construct and own the Carillo Street steam plant, a gas-fired steam-generating facility. The plant provides steam to each entity's respective buildings and is managed by the University. The University maintains an ownership interest of 78.1%, with UPMC having an ownership interest of 21.9%.

A lease arrangement exists between the University and the commonwealth for WPIC. Since 1949, the University has managed WPIC under an agreement between the University and the commonwealth whereby the University rents for a consideration of $1 per year the land, building, equipment, and other items that are used by WPIC. The agreement provides for continuing terms of 10 years each; however, this agreement is cancelable by either party on one year's written notice. In 1992, the University subleased to UPMC the land, building, equipment, and other items subject to the current lease arrangement between the commonwealth and the University. This sublease arrangement continued to be in effect during 2011 and 2010. Included in property, plant, and equipment is $194.2 million and $191.1 million at June 30, 2011 and June 30, 2010, respectively, related to the land, buildings, and equipment used by WPIC. Accumulated depreciation related to these assets totaled $152.5 million and $148.4 million at June 30, 2011 and June 30, 2010, respectively.

The University also has an arrangement with UPMC whereby certain research-related costs incurred by UPMC staff (primarily compensation) in relation to WPIC and the University of Pittsburgh Cancer Institute (UPCI) research awards are charged to such awards via an electronic billing and reimbursed to UPMC each month. Payments totaled $33.7 million in 2011 and $32.5 million in 2010 and are recorded as expenses in the Consolidated Statements of Activities. All billings are recorded at cost.

UPMC provided support payments to UPCI for various subsidies, research initiatives, and general support. These payments totaled $10.1 million and $11.1 million in 2011 and 2010, respectively.

## Note 14: Commitments and Contingencies

At June 30, 2011 and 2010, the University had outstanding contractual commitments of $138.2 million and $62.8 million, respectively, for property, plant, and equipment expenditures.

The University engages in various leasing activities as both a lessor and lessee. Rental revenue from operating leases was $18.5 million and $19.4 million in 2011 and 2010, respectively. Rental expense for operating leases was $47.0 million in 2011 and $41.8 million in 2010. Minimum future rental revenue and expense under operating leases that have initial or remaining noncancelable lease terms for the years ended June 30 are as follows:

| | Rental Revenue | Rental Expense |
|---|---|---|
| | *(in thousands of dollars)* | |
| 2012 | $ 16,321 | $ 42,240 |
| 2013 | $ 14,427 | $ 38,468 |
| 2014 | $ 11,722 | $ 35,921 |
| 2015 | $ 11,103 | $ 34,248 |
| 2016 | $ 10,724 | $ 22,587 |
| Thereafter | $ 10,403 | $ 160,598 |

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

Various legal proceedings involving, among other things, allegations of securities fraud and other securities law violations have been initiated against one of the University's former investment advisers, Westridge Capital Management, Inc. and its related entities ("Westridge"). In connection with these proceedings, restraining orders were granted, assets of Westridge and other named defendants were frozen, and a receiver was appointed. At June 30, 2010, the University's investment in Westridge was reported on the University's audited financial statements at $34.9 million. On April 21, 2011, the University received an initial distribution of $44.4 million from the receivership estate, representing a return of approximately 85% of the University's net investment. The receiver has indicated that additional funds may become available for future distributions to investors from the continued liquidation of the receivership assets and potential recoveries from certain litigation actions. Given the contingent nature of these additional distributions, no receivable has been recorded at June 30, 2011. A limited group of investors have appealed the court order approving the receiver's distribution plan, and such appeals are pending.

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

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

## Note 15: Subsequent Events

The University has evaluated subsequent events through September 21, 2011, the date on which the consolidated financial statements were issued, and determined that there were no subsequent events requiring disclosure or adjustment to the consolidated financial statements.

## Membership of the Board of Trustees Fiscal Year 2011



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