

CONSOLIDATED FINANCIAL STATEMENTS

Kansas University Endowment Association
Years Ended June 30, 2014 and 2013
With Report of Independent Auditors

Ernst & Young LLP



Building a better
working world

Kansas University Endowment Association

Consolidated Financial Statements

Years Ended June 30, 2014 and 2013

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Report of Independent Auditors

The Members
Kansas University Endowment Association

We have audited the accompanying consolidated financial statements of Kansas University Endowment Association, which comprise of the statements of financial position, as of June 30, 2014 and 2013, and the related consolidated statement of activities for the year ended June 30, 2014, and the statements of cash flows for the years ended June 30, 2014 and 2013, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Kansas University Endowment Association as of June 30, 2014 and 2013, its cash flows for the years then ended, and the results of its activities for the year ended June 30, 2014, in conformity with U.S. generally accepted accounting principles.

Report on Summarized Comparative Information

We have previously audited the Kansas University Endowment Association's 2013 consolidated financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated October 25, 2013. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2013, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Ernst + Young LLP

September 26, 2014

Kansas University Endowment Association
Consolidated Statements of Financial Position

	June 30	
	2014	2013
	<i>(In Thousands)</i>	
Assets		
Cash and cash equivalents	\$ 5,567	\$ 9,162
Receivables:		
Receivables from investment activities	450	326
Other receivables	1,582	1,229
Student loans receivable, less allowance of \$1,565 and \$1,601 in 2014 and 2013, respectively	22,097	21,861
Contributions pledged, less allowance of \$1,091 and \$873 in 2014 and 2013, respectively	111,793	59,302
Real estate loans receivable	8,785	3,916
Total receivables	144,707	86,634
Investments:		
Securities	1,579,436	1,371,457
Trusts held by others	43,718	38,360
Interest in other KU Endowment entities	3,579	3,494
Real estate	13,676	13,004
Total investments	1,640,409	1,426,315
Property and facilities:		
Land	12,681	13,942
Buildings	27,605	26,432
Equipment and furnishings	3,310	3,262
	43,596	43,636
Less accumulated depreciation	10,087	8,851
Net property and facilities	33,509	34,785
Deposits and other assets	5,856	5,783
Total assets	\$ 1,830,048	\$ 1,562,679

	June 30	
	2014	2013
	<i>(In Thousands)</i>	
Liabilities and net assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 14,361	\$ 13,275
Payables from investment activities	172	362
Life income gifts payable	21,081	21,334
Agency funds	68,890	60,918
Total liabilities	<u>104,504</u>	95,889
Net assets:		
Unrestricted	191,757	165,401
Temporarily restricted	1,105,509	884,405
Permanently restricted	428,278	416,984
Total net assets	<u>1,725,544</u>	1,466,790

Total liabilities and net assets	<u><u>\$ 1,830,048</u></u>	<u><u>\$ 1,562,679</u></u>
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See accompanying notes.

Kansas University Endowment Association

Consolidated Statement of Activities

	Year Ended June 30, 2014				Summarized Financial Information for the Year Ended June 30, 2013
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	
	<i>(In Thousands)</i>				
Revenues, gains (losses), and other support:					
Fund-raising:					
Contributions and grants received and pledged	\$ 1,192	\$ 164,683	\$ 3,573	\$ 169,448	\$ 127,740
Bequests	3,005	14,836	3,011	20,852	14,564
Life income gifts	-	939	113	1,052	1,104
Change in value of life income gifts	(96)	2,319	(588)	1,635	(329)
Change in net interest in KU Endowment Entities	-	80	-	80	239
Total fund-raising	4,101	182,857	6,109	193,067	143,318
Income from asset holdings:					
Investment income	4,791	9,748	-	14,539	18,002
Realized and unrealized gains on investments and trusts held by others	39,641	144,575	4,500	188,716	96,210
Loan interest income	214	1,028	-	1,242	1,334
Agricultural and mineral income	871	1,472	-	2,343	4,448
Rental, gain on sale of assets, and other income	521	712	-	1,233	556
Total income from asset holdings	46,038	157,535	4,500	208,073	120,550
Other receipts	18	2,002	-	2,020	3,047
Net assets released from restrictions:					
Satisfaction of program restrictions	119,967	(119,967)	-	-	-
Total revenues, gains, and other support	170,124	222,427	10,609	403,160	266,915

Kansas University Endowment Association

Consolidated Statement of Activities (continued)

	Year Ended June 30, 2014			Total	Summarized Financial Information for the Year Ended June 30, 2013
	Unrestricted	Temporarily Restricted	Permanently Restricted		
	<i>(In Thousands)</i>				
Expenses:					
University support:					
Student support	\$ 30,780	\$ –	\$ –	\$ 30,780	\$ 29,524
Faculty support and contractual services	32,635	–	–	32,635	34,590
Construction, furnishings, equipment, and supplies	17,578	–	–	17,578	17,269
Program and other educational support	43,107	–	–	43,107	38,061
Total University support	124,100	–	–	124,100	119,444
Supporting services:					
Administrative and fund-raising support	18,902	–	–	18,902	18,337
Asset management expense	727	–	–	727	707
Depreciation	1,141	–	–	1,141	1,022
Total supporting services	20,770	–	–	20,770	20,066
Total expenses	144,870	–	–	144,870	139,510
Excess of revenues over expenses	25,254	222,427	10,609	258,290	127,405
Net interfund transfers	638	(1,323)	685	–	–
Change in net assets before amortization of pension adjustments	25,892	221,104	11,294	258,290	127,405
Amortization of pension adjustments	464	–	–	464	2,005
Change in net assets	26,356	221,104	11,294	258,754	129,410
Net assets at beginning of year	165,401	884,405	416,984	1,466,790	1,337,380
Net assets at end of year	\$ 191,757	\$ 1,105,509	\$ 428,278	\$ 1,725,544	\$ 1,466,790

See accompanying notes.

Kansas University Endowment Association

Consolidated Statements of Cash Flows

	Year Ended June 30	
	2014	2013
	<i>(In Thousands)</i>	
Operating activities		
Change in net assets	\$ 258,754	\$ 129,410
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	1,141	1,022
Net realized and unrealized gains on investments and trusts held by others	(188,716)	(96,210)
Contributions restricted for long-term investment	(26,247)	(31,201)
Noncash contributions	(1,318)	(13,631)
Changes in operating assets and liabilities:		
Increase in student loan receivable, net	(236)	(33)
(Increase) decrease in contributions pledged, net	(52,491)	5,836
(Increase) decrease in real estate loans	(4,869)	880
Increase (decrease) in accounts payable and accrued expenses	1,086	(58)
Change in agency funds	1,480	705
Increase in net interest of KU Endowment entities	(85)	(239)
Other	(1,062)	(669)
Net cash used in operating activities	<u>(12,563)</u>	<u>(4,188)</u>
Investing activities		
Net expenditures for property and facilities	(111)	(5,667)
Net losses for sale of real estate held for investment	568	-
Net proceeds from sale of investments	93,760	107,461
Purchase of investments	(111,496)	(126,453)
Net cash used in investing activities	<u>(17,279)</u>	<u>(24,659)</u>
Financing activities		
Proceeds from contributions restricted for:		
Permanent endowment	6,697	7,845
Temporary funds	19,550	23,356
Net cash provided by financing activities	<u>26,247</u>	<u>31,201</u>
Net (decrease) increase in cash and cash equivalents	(3,595)	2,354
Cash and cash equivalents at beginning of year	9,162	6,808
Cash and cash equivalents at end of year	<u>\$ 5,567</u>	<u>\$ 9,162</u>

See accompanying notes.

Kansas University Endowment Association

Notes to Consolidated Financial Statements

June 30, 2014

1. Organization

The Kansas University Endowment Association (KU Endowment) is an independent, nonprofit organization serving as the official fund-raising and fund-management foundation for the University of Kansas (the University). Founded in 1891, KU Endowment is the oldest foundation of its kind and one of the largest at a public university in the United States. KU Endowment partners with donors in providing philanthropic support to build a greater university.

KU Endowment is an organization as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and has received an Internal Revenue Service (IRS) determination letter stating that its exempt function income is exempt from tax, pursuant to Section 501(a) of the Code. Accordingly, income taxes are not provided for in the accompanying consolidated financial statements.

2. Summary of Significant Accounting Policies

Basis of Presentation

KU Endowment's consolidated financial statements have been prepared in accordance with U.S generally accepted accounting principles (GAAP). The following is a summary of the significant accounting and reporting policies used in preparing the accompanying consolidated financial statements.

KU Endowment has four wholly owned LLC companies to hold rental properties that are purchased or contributed to benefit the University. The assets and financial activity of the LLCs are presented in the accompanying consolidated financial statements. All material intercompany balances eliminate upon consolidation.

Fund Accounting

To ensure observance of limitations and restrictions that donors have placed on the use of resources available to KU Endowment, the accounts of KU Endowment are maintained in accordance with the principles of fund accounting. This is the procedure by which resources for various purposes, as specified by the resource donor, are classified for accounting and reporting purposes into separate fund accounts that are established according to their individual nature and purpose. However, these separate accounts that have similar characteristics have been combined into groups in the accompanying consolidated financial statements, and all financial transactions have been recorded and reported accordingly, by fund groups.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Funds have been grouped by classification into three categories: unrestricted, temporarily restricted, and permanently restricted. Unrestricted funds represent assets and contributions that are available for the broad benefit of the University but are not otherwise restricted by donors. Temporarily restricted funds represent assets and contributions with a donor-imposed restriction that permits the organization to use or expend the donated assets as specified, and the restriction is satisfied either by the passage of time or by actions of the organization. Permanently restricted funds represent assets and contributions with a donor-imposed restriction that stipulates that the resources be maintained permanently but permits the organization to use or expend part or all of the income derived from the donated assets.

Cash and Cash Equivalents

KU Endowment considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Student Loans Receivable

Interest on loans that are more than 90 days past due is fully reserved for by KU Endowment. As of June 30, 2014 and 2013, there was \$2,852,000 and \$2,780,000, respectively, of loans 90 days or more past due. Interest is accrued, but is fully reserved for on loans that are more than 90 days and less than 180 days past due at 5% and on loans 180 days or more past due at 14%. KU Endowment writes off uncollectible loans, both principal and interest, after the external collection agency partners have determined that they are uncollectible.

Pledges, Contributions, Bequests, and Grants

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received or the condition has been satisfied. Contributions are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction is satisfied (as to either time or purpose), temporarily restricted net assets are reclassified as unrestricted net assets and reported in the accompanying consolidated statement of activities as net assets released from restrictions.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

All unconditional contributions, bequests, and grants are included in revenue of unrestricted net assets at the time they are received or pledged. Donated property is recorded at fair market value on the date it is received or pledged.

Real Estate Loans

Real estate loans represent long term loans for University-related construction projects that will be repaid by the University or its affiliates.

Investment Programs

Short-Term Investment Program

KU Endowment invests the excess cash balances in individual fund accounts by pooling them into a short-term investment program to produce a net investment yield. The total investment yield, less distributions of earnings to certain accounts, is retained by KU Endowment and is allocated to the unrestricted net asset classification to defray administrative costs.

Long-Term Investment Program

The individual fund accounts also may invest in the Long-Term Investment Program (LTIP), which are pooled together for investment purposes. Investment earnings of the LTIP are allocated to participating fund accounts on a market-value unit basis. Amounts allocated to participating fund accounts, under KU Endowment's spending policy, are based on a constant growth spending policy, where spending is adjusted annually by inflation, measured by the Consumer Price Index for All Urban Consumers (CPI-U). The target spending rate of the constant growth spending policy is 5.5% of the market value, with 4.6% out of 5.5% being allocated to participating funds for current expenditure. An amount equal to 0.9% out of 5.5% is allocated to the unrestricted fund group to defray administrative costs. To avoid potential under-distributions or unsustainable over-distributions relative to the current market value in any given year, the constant growth spending policy is subject to a 4.5% floor and a 6.5% cap of the trailing four-quarter average market value. The constant growth spending policy was approved by the executive committee May 30, 2012, and became effective for the spending year that began February 1, 2013.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Amounts allocated to participating fund accounts, under KU Endowment's spending policy prior to February 1, 2013, are based on a fixed rate of return of 4.6% of the 12-quarter moving average market value at September 30. An amount equal to 0.9% of the average market value, as previously defined, is retained by KU Endowment and is allocated to the unrestricted fund group to defray administrative costs. In November 2008, the executive committee intervened in the stated spending policy and reduced spending by 10.0% for the spending year beginning February 1, 2009, which was held constant for each succeeding year through January 31, 2013. This intervention was intended to smooth the impact of the extreme market volatility during the period and provide a stable spending distribution to participating funds.

Investment earnings, including interest, dividends, realized gains (losses), and unrealized gains (losses) in excess of amounts allocated as described above (accumulated investment earnings), are maintained in the LTIP. Such accumulated investment earnings are classified for consolidated financial statement purposes as temporarily restricted or agency funds based on the donor's intentions for the use of the income in conjunction with KU Endowment's spending policy.

Unfunded Investment Commitments

The Company's unfunded investment purchase commitments at June 30, 2014 and 2013, were \$118 million and \$92 million, respectively. Of these amounts, all of the commitments would be categorized in Level 3 of fair value hierarchy or as equity method investments.

Investment Earnings

Investment earnings that are distributed to individual fund accounts as expendable resources, in accordance with KU Endowment LTIP spending policy, are classified as unrestricted or temporarily restricted primarily based on the donor's intentions for the use of the account (see Long-Term Investment Program). The spending policy determines investment earnings that can be spent and investment earnings that are treated as temporarily restricted funds functioning as an endowment.

Realized gains and losses on sales of investments are computed on an average-cost basis. Income from asset holdings is reported net of related investment expenses of \$6,123,000 and \$5,296,000 for the years ended June 30, 2014 and 2013, respectively.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

KU Endowment has invested in bank common trust funds that retain all dividends for reinvestment. Such dividends have been recorded as investment earnings and as an increase in the cost of the fund.

Property and Facilities

Assets acquired are recorded at cost if purchased. Assets held for future earnings potential are classified as investments in the accompanying consolidated statements of financial position. Improvements and replacements are capitalized, and repairs and maintenance are expensed as incurred. Assets held for use by the University or KU Endowment are classified as property and facilities.

Assets contributed are recorded at fair value at the date of donation. If the donor stipulates how long the asset must be used, the contribution is recorded as restricted support. In the absence of such stipulations, the contribution is recorded as unrestricted support.

Depreciation of assets held for use is computed over the estimated useful lives of the respective assets using the straight-line method. Estimated useful lives used by principal asset groups for calculating depreciation are as follows:

<u>Assets</u>	<u>Estimated Useful Life</u>
Buildings:	
New:	
Laboratories	30 years
Other	30 – 50 years
Used	10 – 30 years
Building improvements	8 – 30 years
Equipment and furnishings	3 – 15 years

Agency Funds

KU Endowment holds certain endowment and other funds on behalf of the University and other affiliated third parties. Such funds totaled \$68,890,000 and \$60,918,000 at June 30, 2014 and 2013, respectively.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

University Support

Expenses include distributions to support purposes of the University as a whole, as well as specific departments or schools of the University. Certain distributions, such as faculty and staff salary support, are made to the University, while others, such as student awards, are paid directly to the recipients. Total University support was \$124,100,000 and \$119,444,000 during the years ended June 30, 2014 and 2013, respectively.

Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments that appears on the accompanying consolidated statements of financial position, for which it was practicable to estimate that value (for all categories listed, the carrying value approximates fair value):

Cash and Cash Equivalents – Cash and cash equivalents are defined as cash on hand and cash in demand accounts.

Contributions Pledged – Fair value, after allowance for uncollectible pledges, was determined by discounting the expected future cash flows.

Loans Receivable – Loans receivable are reported in the accompanying consolidated statements of financial position as outstanding principal, adjusted for the allowance for doubtful accounts. Management estimates the allowance for doubtful accounts based on losses inherent in the loan portfolio and existing economic conditions.

Investments – Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair value, with gains and losses included in the accompanying consolidated statement of activities. The fair value is estimated based on prices quoted by securities dealers or brokers, investment bankers, or valuation specialists on the valuation date. Management's estimate of the fair value of investments is included in Note 5.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

KU Endowment invests in limited partnerships and commingled vehicles, some of which employ traditional strategies in readily marketable securities and others of which employ less traditional strategies. The fair value of alternative investments is generally determined by an investment manager of the individual investment fund based on the net asset value of the underlying investments. The alternative investments are accounted for using the equity method of accounting. A portion of the underlying alternative investments is not readily marketable. Therefore, its estimated fair value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed.

Trusts Held by Others – Trusts that provide an irrevocable beneficial interest to KU Endowment that are administered by third parties for the benefit of KU Endowment are included in the consolidated financial statements at the fair value of the assets contributed to the trust. Changes in the fair value of the trusts that exist in perpetuity are recorded in the accompanying consolidated statement of activities as permanently restricted.

Life Income Gifts – Life income gifts consist primarily of gift annuities and charitable remainder trusts and are recognized at fair value in the period the trust is established and adjusted accordingly. Assets of such gifts are reported as a component of investment securities. Liabilities incurred related to the acceptance of life income gifts are recognized at the present value of the expected future cash payments and are discounted at rates specified by the Code Section 7520(a). Generally, the terms of the life income gifts require KU Endowment to pay a specified amount or percentage of a fund's market value to a designated beneficiary for a specified term or the beneficiary's life span. Actuarial assumptions related to mortality are based on tables published by the IRS. Obligations to beneficiaries at June 30, 2014, were \$6,880,000 for gift annuities and \$14,201,000 for charitable remainder trusts. Obligations to beneficiaries at June 30, 2013, were \$8,242,000 for gift annuities and \$13,092,000 for charitable remainder trusts.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue, gains, and other support and expenses during the reporting periods. Actual results could differ from those estimates.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Concentrations of Credit Risk

Financial instruments that potentially subject KU Endowment to concentrations of credit risk include cash and cash equivalents, investments, loans receivable, and contributions receivable. Investments and cash and cash equivalents are managed within guidelines established by KU Endowment, which, as a matter of policy, requires prudent diversification in order to minimize risk exposures. Concentrations of credit risk with respect to loans receivable and contributions receivable are limited since amounts are generally due from a large number of individual donors or corporations.

KU Endowment's investment programs are exposed to various kinds and levels of risk. Fixed-income securities expose KU Endowment to interest rate risk, credit risk, and liquidity risk. The current value of many fixed-income securities is affected as interest rates change, particularly those with fixed interest rates. Credit risk is the risk that the obligor of the security will not fulfill its obligation. Liquidity risk is affected by the willingness of market participants to buy and sell given securities.

Equity securities expose KU Endowment to market risk, performance risk, and liquidity risk. Market risk is the risk associated with major movements of equity markets, both domestic and international. Performance risk is the risk associated with a particular company's operating performance. Liquidity risk, as previously defined, tends to be higher for international equities and small capitalization equity companies.

2013 Financial Information

The accompanying consolidated financial statements include certain prior-year summarized, comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with U.S. GAAP. Accordingly, such information should be read in conjunction with the organization's consolidated financial statements for the year ended June 30, 2013, from which the summarized information was derived.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Reclassifications

Certain amounts appearing in the prior year consolidated financial statements have been reclassified to conform to the current year presentation. The effect of such reclassifications did not change total net assets.

3. Contributions Receivable

Contributions are generally recognized as revenue, gains, and other support at fair value, when unconditional contributions are made. Contributions receivable at June 30, 2014 and 2013, are classified in the accompanying consolidated financial statements as follows (in thousands):

	2014	2013
Temporarily restricted	\$ 112,418	\$ 59,443
Permanently restricted	466	732
	\$ 112,884	\$ 60,175

Contributions receivable at June 30, 2014 and 2013, are due to be received in the following periods (in thousands):

	2014	2013
Receivable in less than one year	\$ 49,914	\$ 28,382
Receivable in one to five years	55,041	30,537
Receivable after five years	12,797	3,951
Total undiscounted contributions receivable	117,752	62,870
Less present value discount (weighted-average discount rate of 1.77% in 2014 and 2.18% in 2013)	(4,868)	(2,695)
	112,884	60,175
Less allowance for doubtful contributions	(1,091)	(873)
Contributions receivable, net	\$ 111,793	\$ 59,302

An allowance for doubtful contributions is estimated from past due pledge balances. Special consideration is given to significant pledges for which KU Endowment is concerned about future collectability.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

4. Securities

Securities, carried at fair value or amounts that approximate fair value, consist of the following (in thousands):

	June 30	
	2014	2013
Money market and short-term investments	\$ 55,412	\$ 70,110
Domestic equity	46,081	48,949
International equity	474	134
U.S. treasury obligations	756	923
Exchange-traded funds	29,078	20,982
Open-ended mutual funds	353,222	274,622
Closed-ended mutual funds	43,392	44,183
Collateralized mortgage obligations	58,335	49,770
Common trust funds – equities	316,491	276,920
Common trust funds – fixed income	66,430	58,728
Real estate	1,818	1,722
Royalties and mineral interests	169	120
Marketable alternatives	398,972	349,421
Nonmarketable alternatives	103,670	64,610
Other LLCs and LLPs	105,136	110,263
	\$ 1,579,436	\$ 1,371,457

The common trust funds – equities and fixed income are generally redeemable in less than 30 days. Marketable alternatives, nonmarketable alternatives, and other LLCs and LLPs (alternative investments) included in the table above represent assets accounted for using the equity method of accounting. The primary objectives for these alternative investments are to improve diversification and reduce volatility. These investments have various liquidity schedules, which are monitored on a continuous basis. The underlying investment strategies for these investments include hedge funds, private equity, venture capital, private real estate, and both domestic and foreign equities.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

5. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Accounting Standards Codification (ASC) 820, *Fair Value Measurement*, issued by the Financial Accounting Standards Board, establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). In determining fair value, KU Endowment uses various methods, including market, income, and cost approaches. Based on these approaches, KU Endowment utilizes certain assumptions that market participants would use in pricing the assets, including assumptions about risk and the risks inherent in the inputs to the valuation techniques. The inputs can be readily observable, market corroborated, or generally unobservable inputs. KU Endowment uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The observability of the inputs used in the valuation techniques is the basis for determining the appropriate fair value hierarchy level.

Certain of KU Endowment's financial assets and financial liabilities are measured at fair value on a recurring basis, including money market, fixed-income, and equity instruments. The three levels of the fair value hierarchy and a description of the valuation methodologies used for instruments measured at fair value are as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities as of the reporting date. Level 1 primarily consists of financial instruments, such as money market securities and exchange-traded equities.

Level 2 – Pricing inputs other than quoted prices included in Level 1 that are either directly observable or that can be derived or supported from observable data as of the reporting date. Instruments in this category include certain U.S. government agency and sponsored entity debt securities and commingled common trust funds.

Level 3 – Pricing inputs include those that are significant to the fair value of the financial asset or financial liability and are not observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

5. Fair Value Measurements (continued)

KU Endowment's alternative investments totaled \$608,100,000 and \$524,294,000 at June 30, 2014 and 2013, respectively. These investments provide KU Endowment with a proportionate share of the investment gains (losses) and are accounted for using the equity method of accounting; thus, they are excluded from the scope of ASC 820.

The fair value of financial assets measured at fair value on a recurring basis was determined using the following inputs at June 30, 2014 (in thousands):

	Fair Value Measurements at Reporting Date Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Money markets and short-term investments	\$ 55,412	\$ 55,412	\$ —	\$ —
Marketable domestic equity	46,081	46,081	—	—
Marketable international equity	474	474	—	—
U.S. treasury obligations	756	—	756	—
Open-ended mutual funds	353,222	353,222	—	—
Closed-ended mutual funds	43,392	43,392	—	—
Exchange-traded funds	29,078	29,078	—	—
Collateralized mortgage obligations	58,335	—	58,335	—
Common trust funds – equities	316,491	—	316,491	—
Common trust funds – fixed income	66,430	—	66,430	—
Real estate	1,818	—	—	1,818
Royalties and mineral rights	169	—	—	169
	971,658	527,659	442,012	1,987
Trusts held by others	43,718	27,840	9,338	6,540
Interest in other KU Endowment entities	3,257	3,035	222	—
	\$ 1,018,633	\$ 558,534	\$ 451,572	\$ 8,527

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

5. Fair Value Measurements (continued)

Changes in Level 3 fair value measurements were as follows for the year ended June 30, 2014 (in thousands):

Fair value beginning balance at July 1, 2013	\$ 6,036
Transfers into trust held by others	656
Realized and unrealized gains on trusts held by others	1,690
Realized and unrealized gains on royalties and mineral interests	145
Fair value ending balance at June 30, 2014	\$ 8,527

The fair value of financial assets measured at fair value on a recurring basis was determined using the following inputs at June 30, 2013 (in thousands):

	Fair Value Measurements at Reporting Date Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Money markets and short-term investments	\$ 70,110	\$ 70,110	\$ —	\$ —
Marketable domestic equity	48,949	48,949	—	—
Marketable international equity	134	134	—	—
U.S. treasury obligations	923	—	923	—
Open-ended mutual funds	274,622	274,622	—	—
Closed-ended mutual funds	44,183	44,183	—	—
Exchange-traded funds	20,982	20,982	—	—
Collateralized mortgage obligations	49,770	—	49,770	—
Common trust funds – equities	276,920	53,324	223,596	—
Common trust funds – fixed income	58,728	—	58,728	—
Real estate	1,722	—	—	1,722
Royalties and mineral rights	120	—	—	120
	847,163	512,304	333,017	1,842
Trusts held by others	38,360	28,069	6,097	4,194
Interest in other KU Endowment entities	3,494	3,494	—	—
	\$ 889,017	\$ 543,867	\$ 339,114	\$ 6,036

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

5. Fair Value Measurements (continued)

Changes in Level 3 fair value measurements were as follows for the year ended June 30, 2013 (in thousands):

Fair value beginning balance at July 1, 2012	\$ 4,649
Transfers into trust held by others	1,182
Realized and unrealized gains on trusts held by others	18
Realized and unrealized gains on royalties and mineral interests	187
Fair value ending balance at June 30, 2013	<u>\$ 6,036</u>

KU Endowment has adopted ASC 820-10-15-4, *Fair Value Measurements of Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. Under the guidance, a reporting entity is permitted, as a practical expedient, to estimate the fair value of certain portfolio investments on the basis of the net asset value per share. KU Endowment holds certain investments that qualify for the usage of the practical expedient, principally including the common trust funds which can generally be redeemed within 30 days.

The fair values of the securities included in Level 1 were determined through quoted market prices. The fair values of Level 2 securities were determined through evaluated bid prices based on recent trading activity and other relevant information, including market interest rate curves, referenced credit spreads, and estimated prepayment rates, where applicable, which are used for valuation purposes and are provided by third-party pricing services where quoted market values are not available. Level 2 investments include corporate fixed income, government bonds, American depository receipts, collateralized mortgage obligations and commingled common trust funds. Due to the volatility of the capital markets, there is a reasonable possibility of significant changes in fair value and additional gains (losses) in the near term subsequent to June 30, 2014.

The fair value of trusts held by others is estimated based on KU Endowment's beneficial interests in the trusts held by others. Certain of the underlying investments within the trusts held by others utilize significant unobservable inputs. Thus, KU Endowment's ownership of these underlying investments is categorized as Level 3 in the fair value hierarchy. The fair values of real estate, royalties, and mineral rights are based on inputs that are not observable in the market. Thus, KU Endowment's ownership of these investments is categorized as Level 3 in the fair value hierarchy.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

6. Benefit Plans

Pension Plan

KU Endowment has a defined benefit pension plan that provides the participants of the plan with a life annuity benefit. Employees of KU Endowment meeting years of service requirements are eligible to participate in the plan with contributions funded solely by KU Endowment. KU Endowment's policy is to make periodic employer contributions in conformance with at least the minimum funding requirements as set forth in the Employee Retirement Income Security Act of 1974, as amended (ERISA).

The benefit obligation is the present value of benefits for all retired and vested terminated participants, plus a present value of benefits for active participants, based on service rendered prior to June 30, 2014, and projected future pay levels at expected retirement ages. The plan's funded status and amounts recognized in KU Endowment's consolidated statements of financial position are as follows (in thousands):

	2014	2013
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 24,272	\$ 23,919
Service cost	1,149	1,128
Interest cost	1,210	1,053
Actuarial loss (gain)	1,484	(1,292)
Benefits and expenses paid	(498)	(536)
Benefit obligation at end of year	\$ 27,617	\$ 24,272
 Change in plan assets		
Fair value of plan assets at beginning of year	\$ 17,823	\$ 15,872
Actual return on plan assets	2,963	1,403
Employer contribution	1,137	1,084
Benefits and expenses paid	(498)	(536)
Fair value of plan assets at end of year	\$ 21,425	\$ 17,823
 Unfunded status included in accounts payable and accrued expenses	\$ (6,192)	\$ (6,449)

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

6. Benefit Plans (continued)

Federal legislation requires KU Endowment to fund the value of accrued benefits for the pension plan over time, based on the average discount rate derived from high-quality corporate bonds. The intent of the legislation is to measure the plan's liability based on benefits earned to date by plan participants. For the plan years ended June 30, 2014 and 2013, the percentage of the value of accrued benefits then funded in the plan was 110.1% and 116.6%, respectively, as certified by KU Endowment's actuarial consultant. The Plan's Accumulated Benefit Obligation was \$23,823,000 on June 30, 2014 and \$20,069,000 on June 30, 2013.

Included in unrestricted net assets at June 30 are the following amounts that have not yet been recognized in net periodic pension cost (in thousands):

	2014	2013
Unrecognized actuarial losses	\$ 5,670	\$ 6,134

Changes in plan assets and benefit obligations in unrestricted net assets during the years ended June 30, include (in thousands):

	2014	2013
Unrecognized actuarial gain	\$ (110)	\$ (1,462)
Amortization of actuarial loss	(354)	(543)
	\$ (464)	\$ (2,005)

The amount of unrecognized actuarial losses expected to be recognized through net periodic pension cost during the year ending June 30, 2015, is \$291,000.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

6. Benefit Plans (continued)

The components of net periodic pension cost were as follows for the years ended June 30 (in thousands):

	2014	2013
Service cost	\$ 1,149	\$ 1,128
Interest cost	1,210	1,053
Expected return on plan assets	(1,369)	(1,233)
Recognized net actuarial loss	354	543
Net periodic pension cost	\$ 1,344	\$ 1,491

KU Endowment's funding policy is to make at least the minimum annual contributions required by ERISA. The expected total contributions during the year ending June 30, 2015, will be \$1,500,000.

KU Endowment's asset-allocation target is 70% equity and 30% fixed income for pension fund assets. Actual pension plan weighted-average asset allocations by asset category are as follows:

	June 30	
	2014	2013
Asset category		
Equity securities	73.0%	72.1%
Debt securities	27.0%	27.4
Other	-	0.5
	100.0%	100.0%

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

6. Benefit Plans (continued)

The fair value of pension plan assets was determined using the following inputs at June 30, 2014 (in thousands):

	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money markets and short-term investments	\$ 85	\$ 85	\$ -	\$ -
International enhanced cash funds	2,367	2,367	-	-
Domestic equity funds	6,980	6,980	-	-
International equity funds	5,110	5,110	-	-
International balanced funds	1,217	1,217	-	-
Domestic fixed-income funds	5,666	5,666	-	-
	\$ 21,425	\$ 21,425	\$ -	\$ -

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

6. Benefit Plans (continued)

The fair value of pension plan assets was determined using the following inputs at June 30, 2013 (in thousands):

	<u>Fair Value Measurements Using</u>			
	<u>Fair Value</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Money markets and short-term investments	\$ 111	\$ 111	\$ —	\$ —
International enhanced cash funds	1,787	1,787	—	—
Domestic equity funds	5,702	5,702	—	—
International equity funds	4,295	4,295	—	—
International balanced funds	1,041	1,041	—	—
Domestic fixed-income funds	4,887	4,887	—	—
	<u>\$ 17,823</u>	<u>\$ 17,823</u>	<u>\$ —</u>	<u>\$ —</u>

The actuarial valuation of the plan used a 7.5% long-term return assumption. This is consistent with the return expectations for a diversified, equity-oriented portfolio of publicly traded stocks and bonds over long-term periods. KU Endowment's review of long-term risk and return assumptions supports this target allocation.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

6. Benefit Plans (continued)

The assumptions used in determining pension information for the plan for the years ended June 30, using a June 30 measurement date, were as follows:

	2014	2013
Benefit obligations:		
Weighted-average discount rate	4.32%	4.82%
Rate of compensation increase	2.50% – 6.50%	3.07% – 7.07%
Benefit costs:		
Weighted-average discount rate	4.82%	4.25%
Expected return on plan assets	7.50%	7.50%
Rate of compensation increase	3.07% – 7.07%	2.50% – 6.50%

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in thousands):

Fiscal Year	Future Expected Benefit Payments
2015	\$ 625
2016	658
2017	676
2018	720
2019	892
2020 – 2024	6,771

Defined Contribution Plan

KU Endowment also has a 401(k) Plan (the Plan), which is a defined contribution plan that covers substantially all employees meeting the eligibility requirements set forth under the Plan. KU Endowment contributes an amount based on a percentage of the amount contributed to the Plan by eligible employees. KU Endowment recorded expenses of \$477,000 and \$434,000 related to the Plan during fiscal years 2014 and 2013, respectively, which are included in administrative and fund-raising support in the accompanying consolidated statement of activities.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

7. Temporary Restrictions Satisfied

For the years ended June 30, 2014 and 2013, temporarily restricted net assets were released from restrictions by incurring expenses satisfying the restricted purposes or by the occurrence of other events specified by donors (in thousands).

	2014	2013
Program restrictions:		
University support:		
Student support	\$ 29,946	\$ 28,034
Faculty support and contractual services	31,854	33,981
Construction, furnishings, equipment, and supplies	17,389	16,748
Program and other educational support	40,778	37,522
	\$ 119,967	\$ 116,285

8. Temporarily Restricted Net Assets

Temporarily restricted net assets available at June 30 are restricted for the following purposes (in thousands):

	2014	2013
Scholarships, fellowships, and awards	\$ 328,051	\$ 251,753
Construction	109,618	54,748
Equipment	5,705	5,169
Research	66,010	57,075
Salaries and services	195,159	162,013
Other University support	400,966	353,647
	\$ 1,105,509	\$ 884,405

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

9. Permanently Restricted Net Assets

Permanently restricted net assets by purpose at June 30 are as follows (in thousands):

	<u>2014</u>	<u>2013</u>
Scholarships, fellowships, and awards	\$ 160,814	\$ 156,412
Equipment	2,397	2,374
Research	25,136	24,081
Salaries and services	96,023	95,090
Other University support	143,908	139,027
	<u>\$ 428,278</u>	<u>\$ 416,984</u>

The income generated from these permanently restricted assets is to be used for activities relating to the purpose.

10. Endowment

KU Endowment's endowment consists of approximately 3,020 individual fund accounts established for a variety of purposes to benefit the University. Its endowment includes both donor-restricted endowment funds and funds designated by the board of trustees to function as endowments. Net assets associated with endowment funds, including funds designated by the board of trustees to function as endowments, are classified and reported on the existence or absence of donor-imposed restrictions.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

10. Endowment (continued)

Interpretation of Relevant Law

KU Endowment has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, KU Endowment classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until the donor's restriction is met. In accordance with UPMIFA, KU Endowment considers the following factors in making a determination whether to appropriate or to accumulate donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of KU Endowment
- The investment policies of KU Endowment.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

10. Endowment (continued)

At June 30, 2014, the endowment net assets' composition, by type of fund, consisted of the following (in thousands):

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ 3,303	\$ 602,146	\$ 375,200	\$ 980,649
Board-designated endowment funds	3,247	-	-	3,247
Total funds	<u>\$ 6,550</u>	<u>\$ 602,146</u>	<u>\$ 375,200</u>	<u>\$ 983,896</u>

For the year ended June 30, 2014, the changes in the endowment net assets are as follows (in thousands):

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 6,356	\$ 488,345	\$ 368,615	\$ 863,316
Investment return:				
Investment income	77	7,181	-	7,258
Net appreciation	420	118,954	-	119,374
Total investment return	497	126,135	-	126,632
Contributions	-	19,489	5,835	25,324
Appropriation of endowment assets for expenditure	(196)	(29,621)	-	(29,817)
Other changes:				
Other receipts	610	729	-	1,339
Interfund transfer within KU Endowment fund accounts, including wholly expendable accounts	(717)	(2,931)	750	(2,898)
Endowment net assets, end of year	<u>\$ 6,550</u>	<u>\$ 602,146</u>	<u>\$ 375,200</u>	<u>\$ 983,896</u>

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

10. Endowment (continued)

At June 30, 2013, the endowment net assets' composition, by type of fund, consisted of the following (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ 3,433	\$ 488,345	\$ 368,615	\$ 860,393
Board-designated endowment funds	2,923	-	-	2,923
Total funds	\$ 6,356	\$ 488,345	\$ 368,615	\$ 863,316

For the year ended June 30, 2013, the changes in the endowment net assets are as follows (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 6,828	\$ 423,606	\$ 361,992	\$ 792,426
Investment return:				
Investment income	57	6,930	-	6,987
Net appreciation	117	63,789	-	63,906
Total investment return	174	70,719	-	70,893
Contributions	-	22,554	5,904	28,458
Appropriation of endowment assets for expenditure	(199)	(25,673)	-	(25,872)
Other changes:				
Other receipts	1,988	1,222	-	3,210
Interfund transfer within KU Endowment fund accounts, including wholly expendable accounts	(2,435)	(4,083)	719	(5,799)
Endowment net assets, end of year	\$ 6,356	\$ 488,345	\$ 368,615	\$ 863,316

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

10. Endowment (continued)

Funds With Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor contributed, which is defined by KU Endowment as the amount required under UPMIFA to be retained as a fund of perpetual duration. In the absence of donor stipulations or law to the contrary, decreases in the value of assets of a donor-restricted endowment fund to an amount below the historical gift value shall reduce temporarily restricted net assets. Accordingly, the aggregate of these deficiencies shall reduce temporarily restricted net assets to the extent there is net appreciation on related funds with donor-imposed temporary restrictions. Deficiencies of this nature that are reported in temporarily restricted net assets were \$258,000 and \$1,992,000 as of June 30, 2014 and 2013, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the board of trustees.

Any remaining depreciation in excess of amounts classified as temporarily restricted net assets shall reduce unrestricted net assets. There were no deficiencies sufficient enough to reduce unrestricted net assets as of June 30, 2014 or 2013.

Return Objectives and Risk Parameters

KU Endowment has investment policies that attempt to provide a predictable stream of funding to programs supported by operations, as well as endowment donations. Assets are invested in a manner that is intended to produce results that exceed the respective benchmark while assuming a moderate level of investment risk. KU Endowment expects its endowment funds, over time, to provide an average rate of return of approximately 8% annually. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate of return objectives, KU Endowment relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends net of fees). KU Endowment targets a diversified asset allocation to achieve its long-term return objectives within prudent risk constraints.

Kansas University Endowment Association

Notes to Consolidated Financial Statements (continued)

10. Endowment (continued)

Spending Policy and How the Investment Objectives Relate to Spending Policy

Except as specified by the donor, KU Endowment has adopted a constant growth policy in which earnings are allocated monthly for spending using a target spending rate of 5.5% of the market value of the endowment fund investment pool as of September 30. Spending is adjusted annually by inflation, measured by the CPI-U. The policy is subject to a 4.5% floor and a 6.5% cap of the trailing four-quarter average market value. In establishing this policy, KU Endowment considered the long-term expected return on its endowment. Accordingly, over the long term, KU Endowment expects the current spending policy to allow its endowment to grow at an average of the long-term rate of inflation. This is consistent with KU Endowment's objective to maintain the purchasing power of the endowed assets held in perpetuity, as well as to provide additional growth through new gifts.

11. Subsequent Events

KU Endowment evaluated events and transactions occurring subsequent to June 30, 2014 through September 26, 2014, the date of issuance of the consolidated financial statements. During this period, there were no subsequent events requiring recognition or disclosure in the consolidated financial statements.

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