PennState

Audited Financial Statements

The Pennsylvania State University
Fiscal Year Ended June 30, 2019

THE PENNSYLVANIA STATE UNIVERSITY

UNIVERSITY OFFICERS

as of October 25, 2019

ERIC J. BARRON
President

STEPHEN S. DUNHAM
Vice President and General Counsel

DAVID J. GRAY
Senior Vice President for
Finance and Business/Treasurer

A. CRAIG HILLEMEIER
(retired effective 6/30/19)
Dean, Penn State College of Medicine;
Chief Executive Officer, Penn State Health; and
Senior Vice President for Health Affairs,
Penn State University

NICHOLAS P. JONES
Executive Vice President
and Provost

STEPHEN M. MASSINI
(appointed effective 7/01/19)
Chief Executive Officer, Penn State Health

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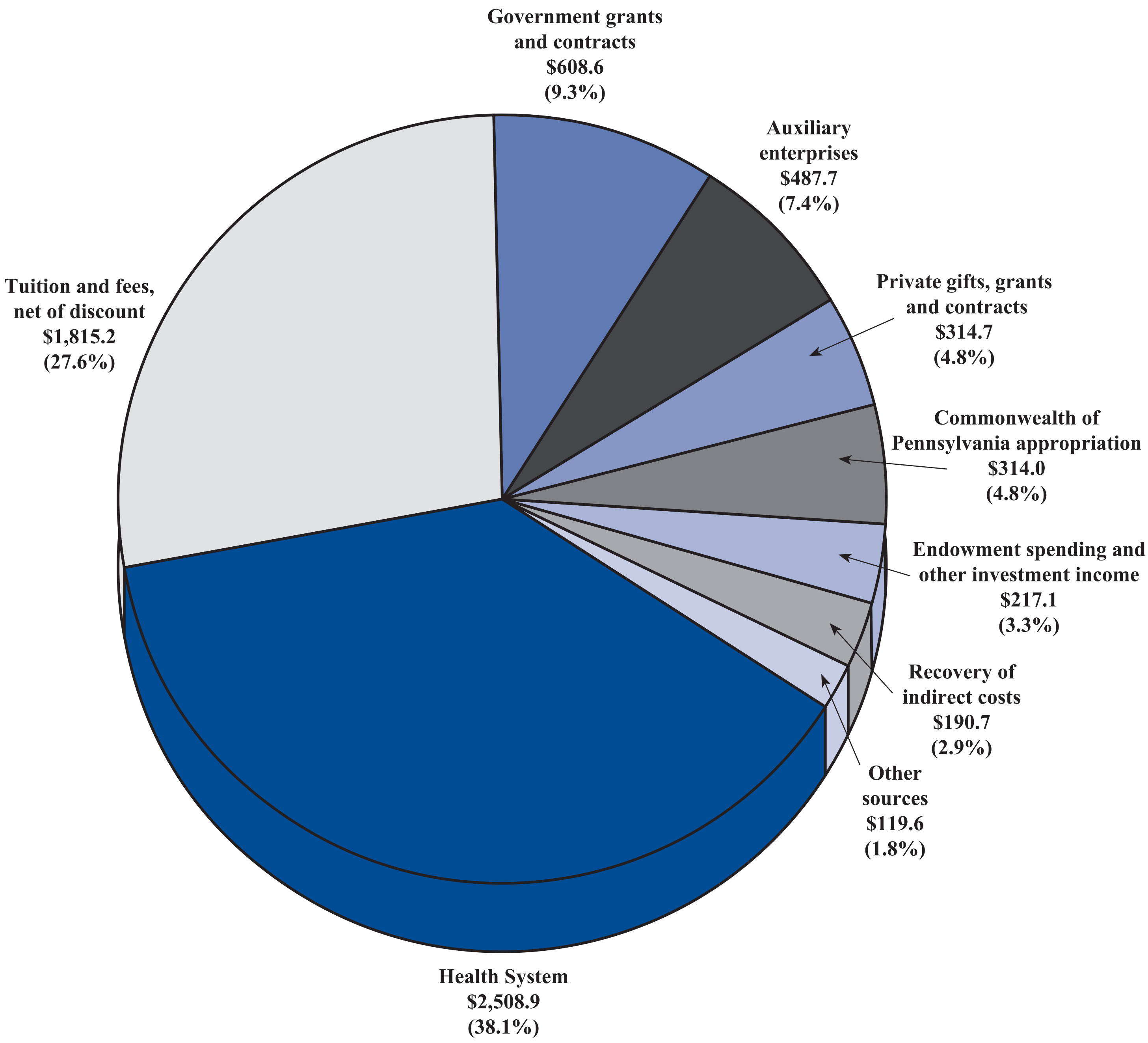
OPERATING REVENUES BY SOURCE ($6.6 billion)

For the Year Ended June 30, 2019

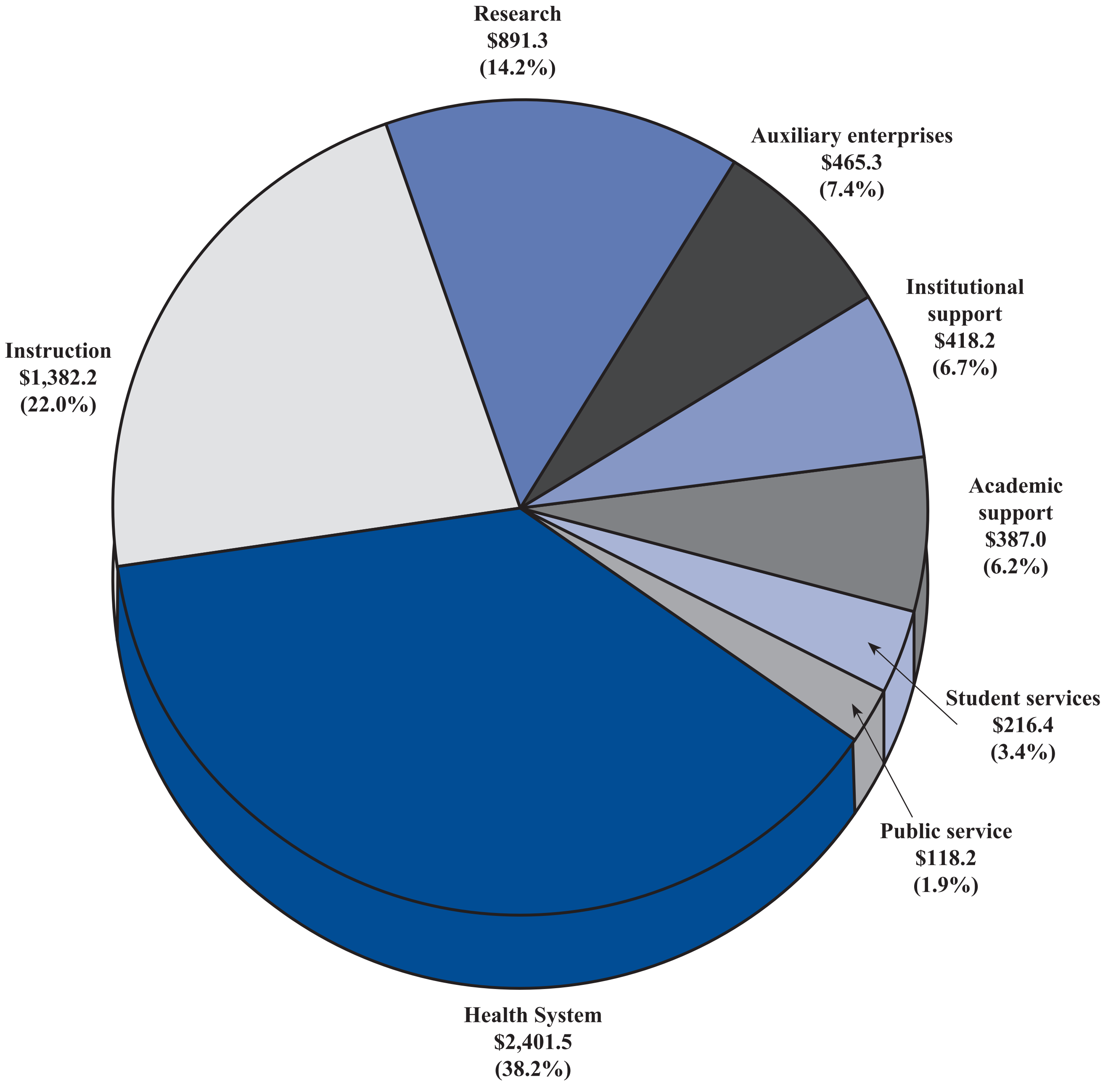
($ in millions)



OPERATING EXPENSES BY FUNCTION ($6.3 billion)

For the Year Ended June 30, 2019

($ in millions)



PennState

Office of the Corporate Controller

The Pennsylvania State University
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University Park, PA 16802-1505
(814) 865-1355
FAX: (814) 863-0701

October 25, 2019

Dr. Eric J. Barron, President
The Pennsylvania State University
201 Old Main
University Park, PA 16802

Dear Dr. Barron:

The audited consolidated financial statements of The Pennsylvania State University and subsidiaries (the "University") for the fiscal years ended June 30, 2019 and 2018 are presented on the accompanying pages. These financial statements represent a complete and permanent record of the finances of the University as of and for the years then ended.

These financial statements have been audited by Deloitte & Touche LLP, independent auditors, and their report has been made a part of this record.

Respectfully submitted,

Joseph J. Doncsecz
Associate Vice President for Finance and Corporate Controller

David J. Gray
Senior Vice President for Finance and Business, and Treasurer

Deloitte & Touche LLP

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of The Pennsylvania State University
University Park, Pennsylvania

We have audited the accompanying consolidated financial statements of The Pennsylvania State University and its subsidiaries (the "University"), which comprise the consolidated statements of financial position as of June 30, 2019 and 2018, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on 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 consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the University as of June 30, 2019 and 2018, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

October 25, 2019

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
ASSETS
JUNE 30, 2019 AND 2018
(in thousands)

	June 30, 2019	June 30, 2018
Current assets:		
Cash and cash equivalents	$ 2,178,713	$ 2,089,105
Short-term investments	407,442	331,421
Deposits held by bond trustees	90,353	87,459
Deposits held for others	40,587	36,845
Accounts receivable, net of allowances of $116,770 and $84,647	656,826	568,924
Contributions receivable, net	40,523	62,318
Loans to students, net of allowances of $603 and $639	7,767	9,352
Inventories	52,516	48,721
Prepaid expenses and other assets	137,764	109,481
Total current assets	3,612,491	3,343,626
Noncurrent assets:		
Deposits held by bond trustees	28,400	15,200
Contributions receivable, net	139,007	134,167
Loans to students, net of allowances of $3,091 and $2,804	46,329	50,015
Total investment in plant, net	5,588,943	5,248,322
Beneficial interest in perpetual trusts	23,898	23,587
Investments	6,304,490	6,065,540
Other assets	177,398	136,815
Total noncurrent assets	12,308,465	11,673,646
Total assets	$15,920,956	$15,017,272

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
LIABILITIES AND NET ASSETS
JUNE 30, 2019 AND 2018
(in thousands)

	June 30, 2019	June 30, 2018
Current liabilities:		
Accounts payable and other accrued expenses	$ 728,510	$ 712,590
Deferred revenue	364,875	358,004
Long-term debt	60,475	57,164
Present value of annuities payable	6,829	6,781
Accrued postretirement benefits	57,457	61,286
Total current liabilities	1,218,146	1,195,825
Noncurrent liabilities:		
Deposits held in custody for others	25,328	28,031
Deferred revenue	615	783
Long-term debt	1,590,177	1,393,013
Present value of annuities payable	50,220	52,455
Accrued postretirement benefits	2,166,578	2,132,269
Refundable United States Government student loans	47,309	46,708
Other liabilities	285,752	243,794
Total noncurrent liabilities	4,165,979	3,897,053
Total liabilities	5,384,125	5,092,878
Net assets:		
Without donor restrictions -		
Undesignated	-	1,743
Designated for specific purposes	4,108,982	3,880,122
Net investment in plant	3,543,893	3,316,763
Total without donor restrictions - The Pennsylvania State University	7,652,875	7,198,628
Noncontrolling interest	252,217	223,647
Total without donor restrictions	7,905,092	7,422,275
With donor restrictions	2,631,739	2,502,119
Total net assets	10,536,831	9,924,394
Total liabilities and net assets	$15,920,956	$15,017,272

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2019
(in thousands)

	Without Donor Restrictions	With Donor Restrictions	Total
Operating revenues and other support:			
Tuition and fees, net of discounts of $230,201	$ 1,815,212	$ -	$ 1,815,212
Commonwealth of Pennsylvania -			
Appropriations	313,967	-	313,967
Special contracts	74,613	-	74,613
Department of General Services projects	15,096	-	15,096
United States Government grants and contracts	518,913	-	518,913
Private grants and contracts	208,207	-	208,207
Gifts and pledges	82,290	24,187	106,477
Endowment spending	117,470	-	117,470
Other investment income	96,898	2,711	99,609
Sales and services of educational activities	108,532	-	108,532
Recovery of indirect costs	190,753	-	190,753
Auxiliary enterprises	487,725	-	487,725
Health System revenue, net of provision for bad debts of $67,188	2,508,876	-	2,508,876
Other sources	11,087	-	11,087
Net assets released from restrictions	60,326	(60,326)	-
Total operating revenues and other support	6,609,965	(33,428)	6,576,537
Operating expenses:			
Educational and general -			
Instruction	1,382,148	-	1,382,148
Research	891,346	-	891,346
Public service	118,241	-	118,241
Academic support	387,035	-	387,035
Student services	216,357	-	216,357
Institutional support	418,167	-	418,167
Total educational and general	3,413,294	-	3,413,294
Auxiliary enterprises	465,294	-	465,294
Health System expense	2,401,501	-	2,401,501
Total operating expenses	6,280,089	-	6,280,089
Increase (decrease) in net assets from operating activities	329,876	(33,428)	296,448
Nonoperating activities:			
Gifts and pledges	-	88,716	88,716
Current year investment returns	264,188	78,706	342,894
Endowment appreciation utilized	(96,811)	-	(96,811)
Changes in funds held by others in perpetuity	-	287	287
Write-offs and disposals of assets	(7,240)	-	(7,240)
Nonperiodic change in postretirement benefit plan	61,205	-	61,205
Other components of net periodic postretirement benefit cost	(96,972)	-	(96,972)
Actuarial adjustment on annuities payable	-	(4,661)	(4,661)
Increase in net assets from nonoperating activities	124,370	163,048	287,418
Increase in net assets - The Pennsylvania State University	454,246	129,620	583,866
Noncontrolling interest:			
Excess of revenues over expenses	28,571	-	28,571
Increase in net assets - noncontrolling interest	28,571	-	28,571
Increase in total net assets	482,817	129,620	612,437
Net assets at the beginning of the year	7,422,275	2,502,119	9,924,394
Net assets at the end of the year	$ 7,905,092	$ 2,631,739	$ 10,536,831

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2018
(in thousands)

	Without Donor Restrictions	With Donor Restrictions	Total
Operating revenues and other support:			
Tuition and fees, net of discounts of $214,774	$ 1,820,971	$ -	$ 1,820,971
Commonwealth of Pennsylvania -			
Appropriations	298,312	-	298,312
Special contracts	70,800	-	70,800
Department of General Services projects	47,809	-	47,809
United States Government grants and contracts	495,851	-	495,851
Private grants and contracts	222,350	-	222,350
Gifts and pledges	75,367	12,433	87,800
Endowment spending	105,183	-	105,183
Other investment income	154,092	1,598	155,690
Sales and services of educational activities	100,992	-	100,992
Recovery of indirect costs	179,879	-	179,879
Auxiliary enterprises	482,089	-	482,089
Health System revenue, net of provision for bad debts of $50,660	2,276,366	-	2,276,366
Other sources	19,648	-	19,648
Net assets released from restrictions	4,318	(4,318)	-
Total operating revenues and other support	6,354,027	9,713	6,363,740
Operating expenses:			
Educational and general -			
Instruction	1,351,915	-	1,351,915
Research	851,662	-	851,662
Public service	96,045	-	96,045
Academic support	376,431	-	376,431
Student services	200,251	-	200,251
Institutional support	357,505	-	357,505
Total educational and general	3,233,809	-	3,233,809
Auxiliary enterprises	443,350	-	443,350
Health System expense	2,121,177	-	2,121,177
Total operating expenses	5,798,336	-	5,798,336
Increase in net assets from operating activities	555,691	9,713	565,404
Nonoperating activities:			
Gifts and pledges	-	99,039	99,039
Current year investment returns	94,620	82,624	177,244
Endowment appreciation utilized	(73,903)	-	(73,903)
Changes in funds held by others in perpetuity	-	3,732	3,732
Write-offs and disposals of assets	(14,887)	-	(14,887)
Nonperiodic change in postretirement benefit plan	243,506	-	243,506
Other components of net periodic postretirement benefit cost	(129,320)	-	(129,320)
Actuarial adjustment on annuities payable	-	(7,957)	(7,957)
Increase in net assets from nonoperating activities	120,016	177,438	297,454
Increase in net assets - The Pennsylvania State University	675,707	187,151	862,858
Noncontrolling interest:			
Capital contributions - Health System	200,000	-	200,000
Excess of revenues over expenses	19,038	-	19,038
Increase in net assets - noncontrolling interest	219,038	-	219,038
Increase in total net assets	894,745	187,151	1,081,896
Net assets at the beginning of the year	6,527,530	2,314,968	8,842,498
Net assets at the end of the year	$ 7,422,275	$ 2,502,119	$ 9,924,394

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2019 AND 2018
(in thousands)

	June 30, 2019	June 30, 2018
Cash flows from operating activities:		
Increase in net assets	$ 612,437	$ 1,081,896
Adjustments to reconcile change in net assets to net cash provided by operating activities -		
Actuarial adjustment on annuities payable	4,661	7,957
Contributions restricted for long-term investment	(115,551)	(93,274)
Interest and dividends restricted for long-term investment	(75,444)	(89,759)
Net realized and unrealized gains on long-term investments	(366,667)	(258,722)
Capital contributions - Health System	-	(200,000)
Depreciation expense	412,577	371,570
Amortization expense	1,171	(194)
Write-offs and disposals of assets	7,240	15,905
Contributions of land, buildings and equipment	(44,452)	(6,625)
Provision for bad debts	84,410	62,616
(Increase) decrease in deposits held for others	(3,743)	186
Increase in receivables	(137,644)	(121,554)
Increase in inventories	(3,794)	(622)
Increase in prepaid expenses and other assets	(22,077)	(41,911)
Increase (decrease) in accounts payable and other accrued expenses	44,667	(7,423)
Increase in deferred revenue	6,742	16,309
Increase (decrease) in accrued postretirement benefits	30,479	(124,909)
Net cash provided by operating activities	435,012	611,446
Cash flows from investing activities:		
Purchase of land, buildings and equipment	(715,582)	(681,899)
(Increase) decrease in deposits held by bond trustees	(16,094)	76,295
Advances on student loans	(3,059)	(10,121)
Collections on student loans	7,503	8,490
Purchase of investments	(2,886,333)	(3,184,549)
Proceeds from sale of investments	2,891,401	3,156,165
Net cash used in investing activities	(722,164)	(635,619)
Cash flows from financing activities:		
Contributions restricted for long-term investment	115,551	93,274
Interest and dividends restricted for long-term investment	75,444	89,759
Capital contributions - Health System	-	200,000
Payments of annuity obligations	(6,858)	(6,810)
Proceeds from long-term debt	250,158	74,607
Principal payments on long-term debt	(58,369)	(99,675)
Proceeds related to government student loan funds, net of collection costs	834	420
Net cash provided by financing activities	376,760	351,575
Net increase in cash and cash equivalents	89,608	327,402
Cash and cash equivalents at the beginning of the year	2,089,105	1,761,703
Cash and cash equivalents at the end of the year	$ 2,178,713	$ 2,089,105

Supplemental disclosures of cash flow information (Note 2)

See notes to consolidated financial statements.

1. THE UNIVERSITY AND RELATED ENTITIES

The Pennsylvania State University (“the University”), which was created as an instrumentality of the Commonwealth of Pennsylvania (“the Commonwealth” or “Pennsylvania”), is organized as a non-profit corporation under the laws of the Commonwealth. As Pennsylvania’s land grant university, the University is committed to improving the lives of the people of Pennsylvania, the nation and the world through its integrated, tri-part mission of high-quality teaching, research and outreach.

Basis of Presentation

The financial statements of the University include, on a consolidated basis, the consolidated financial statements of Penn State Health (“the Health System”), a Pennsylvania non-profit corporation, and its wholly owned subsidiaries (see Note 13 for additional information), and the financial statements of The Corporation for Penn State and its subsidiaries (“the Corporation”). The Corporation is a non-profit member corporation organized in 1985 for the exclusive purpose of benefiting and promoting the interests of the University, the Corporation’s sole member. The Corporation’s financial statements consist primarily of the assets and revenues of The Pennsylvania College of Technology (“Penn College”), a wholly owned subsidiary of the Corporation. All transactions among the University, the Health System, and the Corporation have been eliminated.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The University’s consolidated financial statements are prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America (GAAP). The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) is the source of authoritative GAAP.

The University’s consolidated financial statements include statements of financial position, activities and cash flows. In accordance with FASB ASC requirements, net assets and the changes in net assets are classified as with donor restrictions or without donor restrictions.

Net assets with donor restrictions are net assets subject to donor-imposed restrictions, either in perpetuity or for a specified time or purpose. Net assets with perpetual restrictions consist primarily of the historical amounts of endowed gifts. Additionally, contributions receivable and remainder interests which are required by donors to be retained in perpetuity are included at their estimated net present values. Net assets restricted by time or purpose consist of contributions receivable and remainder interests that are not required to be held in perpetuity. In addition, endowment appreciation and net unrealized losses on donor-restricted endowment funds for which historical cost exceeds market value are included.

Net assets without donor restrictions are net assets not subject to donor-imposed restrictions. These net assets may be designated for specific purposes at the discretion of management or may otherwise be limited by contractual agreements with outside parties. Revenue from donor-restricted sources is reclassified as revenue without donor restrictions when the circumstances of the restriction have been fulfilled. Donor-restricted revenues whose restrictions are met within the same fiscal year are reported as revenue without donor restrictions. All expenses from operations are reported as a reduction of net assets without donor restrictions, since the use of restricted contributions in accordance with donors’ stipulations results in the release of the restriction.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts on the financial statements and the disclosure of contingencies and commitments. Actual results could differ from those estimates.

Revenue Recognition

Tuition revenue is recognized over the course of each semester (summer, fall, spring) as instruction is provided to students. Tuition is due from students by the beginning of each applicable semester. Overdue payments are reflected in accounts receivable as the University has an unconditional right to payment. Tuition included in deferred revenue reflects summer semester tuition collected prior to June 30, but applied to the subsequent fiscal year, as the University does not split summer semester revenue between fiscal years. Tuition receipts of $147.5 million, included in deferred revenue at June 30, 2018, were recognized during the year ended June 30, 2019. Tuition receipts of $143.2 million, included in deferred revenue at June 30, 2017, were recognized during the year ended June 30, 2018. Institutional financial aid provided by the University for tuition and fees is reflected as a reduction of tuition and fee revenue. As tuition contracts have a duration of one year or less, the University has elected to apply the optional exemption prescribed by ASC 606-10-50-14 and, as such, has not disclosed the aggregate transaction price allocated to unsatisfied performance obligations or the time at which the revenue associated with these unsatisfied performance obligations is expected to be recognized. At June 30, unsatisfied performance obligations under tuition contracts relate solely to summer semester instruction to be provided in July and August of the subsequent year. Transaction prices for tuition and fees are determined and allocated based on the applicable published tuition and fees schedules.

Grants and contracts revenue is recognized over time as the eligible grant activities are conducted. Grants and contracts deemed to be exchange transactions fall under the scope of ASC Topic 606, Revenue from Contracts with Customers. The performance obligation for each grant or contract is deemed to be the research itself. Work completed under grants and contracts does not result in assets that can be sold to other customers and the University is entitled to payment for the work completed to date. Grants and contracts that are deemed to be contributions fall under the scope of ASC Topic 958, Not-for-Profit Entities. These are deemed to be conditional contributions, as eligible expenditures must be incurred in order to have a right of release of funding from the sponsor. Most grants and contracts are cost reimbursement basis, and incurred expenditures are periodically billed to the customer for reimbursement. Grants and contracts receipts of $75.2 million, included in deferred revenue at June 30, 2018, were recognized during the year ended June 30, 2019. Grants and contracts receipts of $70.4 million, included in deferred revenue at June 30, 2017, were recognized during the year ended June 30, 2018. The University has entered into numerous grants and contracts, with periods of performance ending at various dates from July 1, 2019 through December 31, 2050. The estimated performance obligations remaining under these grants and contracts as of June 30, 2019 total $761.2 million. Transaction prices for grants and contracts are determined and allocated based on the budgets included in the respective award agreements.

Revenues from sales and services of educational activities and auxiliary enterprises consist primarily of health services, housing and food services, intercollegiate athletics, campus operations, and hospitality services. Performance obligations associated with these contracts consist of the provision of goods or services, and significant judgment is involved to determine whether the performance obligations are satisfied over time or at a point in time. Typically, revenue associated with semester-based contracts, such as housing and food services, is recognized over the course of the semester as services are provided. For other contracts, such as health services, athletic ticket sales, hotel room charges, and other campus operations, revenue is recognized at a point in time, when the good or service is provided. Contracts included in sales and services of educational activities and auxiliary enterprises are typically one year or less in length. As such, receipts included in deferred revenue at June 30, 2018 and 2017 were recognized during the years ended June 30, 2019 and 2018, respectively. In addition, the University has elected to apply the optional exemption prescribed by ASC 606-10-50-14 and, as such, has not disclosed the aggregate transaction price allocated to unsatisfied performance obligations or the time at which the revenue associated with these unsatisfied performance obligations is expected to be recognized. At June 30, unsatisfied performance obligations under sales and services of educational activities and auxiliary enterprises relate primarily to summer semester housing and food services to be provided in July and August of the subsequent year, as well as athletic events held during the fall semester. Transaction prices for sales and services of educational activities and auxiliary enterprises are typically straightforward and explicitly stated in the contract.

The Health System has agreements with third-party payors that provide for payments to its subsidiaries at amounts different from their established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. In addition, net patient service revenue is net of provision for bad debts of $67.2 million and $50.7 million for the years ended June 30, 2019 and 2018, respectively. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined or such estimates change.

The subsidiaries of the Health System provide care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. The Health System does not pursue collection of amounts determined to qualify as charity care; these amounts are not reported as net patient service revenue. The amounts of direct and indirect costs for services and supplies furnished under the Health System's charity care policy totaled approximately $30.4 million and $26.0 million for the years ended June 30, 2019 and 2018, respectively, and is based on a ratio of the Health System's operational costs to its gross charges. The amount of charges foregone for services and supplies furnished under the Health System's charity policy totaled approximately $60.4 million and $53.2 million during 2019 and 2018, respectively.

The University has elected to use the practical expedient prescribed by ASC 606-10-32-18, in which the promised amount of consideration need not be adjusted for the effects of a significant financing component if the period between when promised goods or services are transferred to a customer and when the customer pays for the goods or services is expected to be one year or less at contract inception.

Contributions

Unconditional promises to give are recognized as revenues and receivables in the year made and consist of written or oral promises to contribute to the University in the future. Contributions receivable are recorded as donor-restricted revenue, either due to purpose restrictions and/or the implicit time restriction inherent in the future date at which the contribution is to be received. The amounts are present valued based on timing of expected collections.

Fair Value of Financial Instruments

The University has provided fair value estimates for certain financial instruments. Fair value information presented in the financial statements is based on information available at June 30, 2019 and 2018. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable and other accrued expenses approximate fair value because of the terms and relatively short maturity of these financial instruments. The carrying values of the University's loans to students are also reasonable estimates of their fair value, as the total outstanding loans to students as of June 30, 2019 and 2018 have been made at the rates available to students for similar loans at such times. Investments are reported at fair value as disclosed in Note 4. The fair value of the University's bonds payable is disclosed in Note 8. See Note 6 for further discussion of fair value measurements.

Cash Flows

The following items are included as supplemental disclosure to the statements of cash flows for the years ended June 30:

(in thousands of dollars)	2019	2018
Interest paid	$ 59,135	$ 51,533
Non-cash acquisitions of land, buildings and equipment	53,425	12,426

Capitalized costs accrued related to construction are $76.2 million and $88.7 million as of June 30, 2019 and 2018, respectively. Taxes paid for 2019 and 2018 are considered immaterial. Cash and cash equivalents include certain investments in highly liquid instruments with initial maturities of 90 days or less, except for such assets held by the University's investment managers as part of their long-term investment strategies. Short-term investments include other current investments held for general operating purposes with maturities greater than 3 months but less than 12 months.

Accounts Receivable

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

(in thousands of dollars)	2019	2018
Grants and contracts, net of allowance of $2,105 and $2,267	$ 163,761	$ 181,641
Patient accounts receivable, net of allowance of $91,899 and $61,634	348,331	250,789
Student receivables, net of allowance of $15,467 and $13,840	50,978	49,102
Investment and interest receivable	25,520	7,990
Other, net of allowance of $7,299 and $6,906	68,236	79,402
Total accounts receivable, net	$ 656,826	$ 568,924

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 factors, historical experience, and other currently available evidence. Receivables are written off when management determines they will not be collected.

Related to patient accounts receivable associated with services provided to patients who have third-party coverage, management analyzes contractually due amounts and provides an allowance for doubtful accounts (for example, for expected uncollectible deductibles and copayments or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables from self-pay patients, the subsidiaries of the Health System record a provision for bad debts in the period of service on the basis of past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. In estimating the allowance for doubtful accounts, account age is taken into consideration. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

Loans to Students

Loans to students are disbursed to qualified students based on need and include loans granted by the University from institutional resources and under federal government loan programs. Students enter a grace period upon ceasing at least half-time enrollment status. The grace period varies depending on the type of loan. Upon expiration of the grace period, interest begins to accrue, and repayment begins one month thereafter. Repayments of these loans are made directly to the University. Loans to students are uncollateralized and carry default risk. At June 30, 2019 and 2018, student loans represent 0.3% and 0.4% of total assets, respectively.

Funds advanced by the federal government of $47.3 million and $46.7 million at June 30, 2019 and 2018, respectively, are ultimately refundable to the government and are classified as liabilities in the consolidated statements of financial position. As of June 30, 2018, no additional disbursements are permitted under the federal Perkins loan program. The University is liquidating its Perkins portfolio through collections of outstanding Perkins loans. The federal liability related to the Perkins loan program will be reduced through the return of funds as required by the Department of Education.

Loans to students consisted of the following at June 30:

(in thousands of dollars)		2019		2018
Loans to students:				
Federal government loan programs:				
Perkins loan program	$	37,053	$	42,720
Health Professions Student Loans and Loans for Disadvantaged Students		11		20
Federal government loan programs		37,064		42,740
Institutional loan programs		20,726		20,070
		57,790		62,810
Less allowance for doubtful accounts:				
Balance, beginning of year		(3,443)		(3,118)
Provision for doubtful accounts		(251)		(325)
Balance, end of year		(3,694)		(3,443)
Loans to students, net	$	54,096	$	59,367

Allowances for doubtful accounts are established based on prior collection experience and current economic factors which, in management's judgment, could influence the ability of loan recipients to repay the amounts according to the terms of the loan. Further, the University does not evaluate credit quality of student loans receivable after the initial approval of the loan. Loans to students are considered past due when payment is not received by the due date, and interest continues to accrue until the loan is paid in full or written off. When loans to students are deemed uncollectible, an allowance for doubtful accounts is established.

The University considers the age of the amounts outstanding in determining the collectability of loans to students. The aging of the loans to students based on days delinquent and the related allowance for doubtful accounts at June 30 are as follows:

(in thousands of dollars)

2019	45 days or less	46-75 days	76-105 days	Over 105 days	Total
Loans to students:					
Federal government loan programs	$ 30,702	$ 29	$ 31	$ 6,302	$ 37,064
Institutional loan programs	17,571	16	15	3,124	20,726
Total loans to students	48,273	45	46	9,426	57,790
Allowance for doubtful accounts:					
Federal government loan programs					(484)
Institutional loan programs					(3,210)
Total allowance for doubtful accounts					(3,694)
Total loans to students, net					$ 54,096

(in thousands of dollars)

2018	45 days or less	46-75 days	76-105 days	Over 105 days	Total
Loans to students:					
Federal government loan programs	$ 36,928	$ 37	$ 43	$ 5,732	$ 42,740
Institutional loan programs	17,272	22	19	2,757	20,070
Total loans to students	54,200	59	62	8,489	62,810
Allowance for doubtful accounts:					
Federal government loan programs					(594)
Institutional loan programs					(2,849)
Total allowance for doubtful accounts					(3,443)
Total loans to students, net					$ 59,367

Inventories

Inventories are stated at the lower of cost or net realizable value on the first-in, first-out basis.

Investments

The University's noncurrent investments represent the University's endowment and other investments held for general operating purposes. The University's investments are reported at fair value in the accompanying financial statements. Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair values with gains and losses included in the consolidated statements of activities. In the management of investments, the University authorizes certain investment managers to purchase derivative securities to attain a desired market position; and the University may directly invest in derivative securities to attain a desired market position. The University does not trade or issue derivative financial instruments other than through the investment management practices noted above. The University records derivative securities at fair value with gains and losses reflected in the consolidated statements of activities.

The estimated fair value amounts for marketable debt, equity and fixed income securities held by the University have been determined using available market information as supplied by the various financial institutions that act as trustees or custodians for the University. For non-liquid holdings, generally limited partnership investments in private real estate, venture capital, private equity, natural resources, and private debt, estimated fair value is determined based upon financial information provided by the general partner. This financial information includes assumptions and methods that were reviewed by University management. The University believes that the estimated fair value is a reasonable estimate of market value as of June 30, 2019 and 2018. Because the limited partnerships are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market existed, and such differences could be material.

Income on operating investments and income used for the annual distribution under the annual spending policy for endowments are reported in operating revenues within the consolidated statement of activities.

Beneficial Interest in Perpetual Trusts

The University is the beneficiary of certain perpetual trusts held and administered by outside trustees. The fair value of these trust assets has been recorded as net assets with donor restrictions and related beneficial interest in perpetual trusts in the consolidated financial statements.

Investment in Plant

Total investment in plant as of June 30 is comprised of the following:

(in thousands of dollars)	2019	2018
Land	$ 157,852	$ 149,603
Buildings	7,744,942	7,218,469
Improvements other than buildings	722,140	706,585
Equipment	1,750,893	1,612,938
Total plant	10,375,827	9,687,595
Less accumulated depreciation	(4,786,884)	(4,439,273)
Total investment in plant, net	$ 5,588,943	$ 5,248,322

The value of land, buildings, and equipment is recorded at cost or, if received as gifts, at fair value at date of gift commitment. The University does not capitalize the cost of library books. Depreciation is computed over the estimated useful lives of the assets using the straight-line method. Useful lives range from 4 to 50 years for buildings, 10 to 20 years for improvements other than buildings, and 1 to 20 years for equipment. Depreciation expense was $412.6 million and $371.6 million for the fiscal years ended June 30, 2019 and 2018, respectively. The University has certain building and equipment lease agreements in effect which are considered capital leases that are included as long-term debt in the statements of financial position. These leases have been capitalized at the lower of fair market value or net present value of the minimum lease payments. Buildings and equipment held under capital leases are amortized on a straight-line basis over the shorter of the lease terms or the estimated useful lives of the assets. The capitalized cost and accumulated depreciation of the leases at June 30, 2019 and 2018 were $130.9 million and $71.5 million, and $131.2 million and $68.6 million, respectively.

Accounts Payable and Other Accrued Expenses

Accounts payable and other accrued expenses at June 30 consist of the following:

(in thousands of dollars)	2019	2018
Accounts payable (non-Health System)	$ 270,540	$ 299,611
Health System accounts payable and other accrued expenses	323,729	283,700
Accrued payroll and other related liabilities	113,249	108,782
Accrued bond interest	17,865	17,594
Student deposits	3,127	2,903
Total accounts payable and other accrued expenses	$ 728,510	$ 712,590

Impairment of Long-Lived Assets

Long-lived assets, which include investment in plant and definite-lived intangible assets, are assessed for impairment whenever events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. An impairment loss is recognized in change in net assets in the period that the impairment occurs.

Asset Retirement Obligations

The University has recognized liabilities for asset retirement obligations. The University has identified asbestos abatement and the decommissioning of the Breazeale Nuclear Reactor as conditional asset retirement obligations. These obligations are reported as part of other noncurrent liabilities within the consolidated statement of financial position. The following table details the change in liabilities for the years ended June 30:

	(in thousands of dollars)
Balance as of June 30, 2017	$ 83,213
Adjustment to liability	2,855
Accretion expense	3,577
Liabilities settled	(8,414)
Balance as of June 30, 2018	81,231
Adjustment to liability	8,540
Accretion expense	3,516
Liabilities settled	(10,121)
Balance as of June 30, 2019	$ 83,166

Annuities Payable

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

Net Assets

Net assets consist of the following at June 30:

(in thousands of dollars)	2019	2018
Net assets without donor restrictions:		
Undesignated	$ -	$ 1,743
Designated for specific purposes:		
Designated for plant activities	1,501,045	1,481,893
Health System	1,306,953	1,205,733
Operating budget carryforward	1,053,237	1,072,321
Funds functioning as endowments	860,795	762,836
Designated for scholarships	112,687	107,354
Designated for postretirement benefits	(961,864)	(974,891)
Other designated net assets	236,129	224,876
Total designated for specific purposes	4,108,982	3,880,122
Net investment in plant	3,543,893	3,316,763
Non-controlling interest	252,217	223,647
Total net assets without donor restrictions	$ 7,905,092	$ 7,422,275
Net assets with donor restrictions:		
Endowment funds	$ 2,307,883	$ 2,116,650
Future contributions	200,794	256,628
Split-interest agreements	92,919	100,681
Student loan funds	17,391	17,310
Contributions for property, plant and equipment	12,752	10,850
Total net assets with donor restrictions	$ 2,631,739	$ 2,502,119
Total net assets	$ 10,536,831	$ 9,924,394

Net assets without donor restrictions that are designated for specific purposes have been designated at the discretion of management.

Income Taxes

The University files U.S. federal and state tax returns. The statute of limitations on the University's federal returns generally remains open for three years following the year they are filed. In accordance with ASC Topic 740, Income Taxes, the University continues to evaluate tax positions and has determined there is no material impact on the University financial statements.

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update ("ASU") 2014-09, *"Revenue from Contracts with Customers."* This update clarifies the principles for recognizing revenue that (1) removes inconsistencies and weaknesses in revenue requirements, (2) provides a more robust framework for addressing revenue issues, (3) improves comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets, (4) provides more useful information to users of financial statements through improved disclosure requirements, and (5) simplifies the preparation of financial statements by reducing the number of requirements to which an entity must refer. In August 2015, the FASB issued ASU 2015-14, *"Revenue from Contracts with Customers; Deferral of the Effective Date."* This update defers the effective date of the original ASU. This update was effective for the University beginning July 1, 2018. Although the adoption of this guidance did not have a material impact on the consolidated financial statements, enhanced disclosures related to revenue from contracts with customers have been included in Note 2.

In January 2016, the FASB issued ASU 2016-01, *"Financial Instruments – Overall; Recognition and Measurement of Financial Assets and Financial Liabilities."* This update addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments and was effective for the University beginning July 1, 2018. The adoption of this guidance did not have a material impact on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *"Leases."* This update requires substantial changes to lease accounting to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The main difference between previous GAAP and this guidance is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating under previous GAAP. This update is effective for the University beginning July 1, 2019 with early adoption permitted. The University is currently evaluating the impact this guidance may have on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *"Not-for-Profit Entities; Presentation of Financial Statements of Not-for-Profit Entities."* This update amends the requirements for financial statements and notes in Topic 958, Not-for-Profit Entities. The most significant amendment requires a not-for-profit entity ("NFP") to present on the face of the statement of financial position amounts for two classes of net assets at the end of the period, rather than for the previously required three classes. That is, an NFP will report amounts for *net assets with donor restrictions* and *net assets without donor restrictions*, as well as the currently required amount for total net assets. This update was effective for the University beginning July 1, 2018 and the consolidated financial statements reflect the updated guidance, including the additions of Notes 3 and 10. In addition, the adoption of this guidance resulted in the following net asset reclassifications as of June 30, 2017:

(in thousands of dollars)	ASU 2016-14 Classifications		
Net Asset Classifications	Without donor restrictions	With donor restrictions	Total net assets
As previously presented:			
Unrestricted	$ 6,526,231	$ -	$ 6,526,231
Temporarily restricted	-	708,103	708,103
Permanently restricted	-	1,608,164	1,608,164
Net assets as previously presented	6,526,231	2,316,267	8,842,498
Reclassifications to implement ASU 2016-14:			
Underwater endowments	1,299	(1,299)	-
Net assets, as reclassified	$ 6,527,530	$ 2,314,968	$ 8,842,498

In August 2016, the FASB issued ASU 2016-15, *"Statement of Cash Flows; Classification of Certain Cash Receipts and Cash Payments."* This update provides guidance on eight specific cash flows issues with the objective of reducing the existing diversity in practice and was effective for the University beginning July 1, 2018. The adoption of this guidance did not have a material impact on the consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, *"Compensation – Retirement Benefits; Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost."* This update requires that an employer report the service cost component in the same line items as other compensation costs arising from services rendered by the pertinent employees during the period. In addition, the other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. This update was early adopted by the University in 2019, with retrospective adoption resulting in a reclassification of $129.3 million of operating expenses to other components of net periodic postretirement benefit cost within nonoperating activities on the consolidated statement of activities for the year ended June 30, 2018.

The reclassification adjustments for the year ended June 30, 2018 are as follows:

(in thousands of dollars)

Operating expenses	As previously presented	ASU 2017-07 reclassification	As currently presented
Instruction	$ 1,420,364	$ (68,449)	$ 1,351,915
Research	857,786	(6,124)	851,662
Public service	101,470	(5,425)	96,045
Academic support	399,597	(23,166)	376,431
Student services	208,112	(7,861)	200,251
Institutional support	375,025	(17,520)	357,505
Total educational and general	3,362,354	(128,545)	3,233,809
Auxiliary enterprises	444,125	(775)	443,350
Health System expense	2,121,177	-	2,121,177
Total operating expenses	5,927,656	(129,320)	5,798,336
Nonoperating activities			
Other components of net periodic postretirement benefit cost	-	(129,320)	(129,320)

In June 2018, the FASB issued ASU 2018-08, *"Not-for-Profit Entities; Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made."* This update clarifies and improves current guidance about whether a transfer of assets (or the reduction, settlement, or cancellation of liabilities) is a contribution or an exchange transaction. In addition, this update requires that an entity determine whether a contribution is conditional on the basis of whether an agreement includes a barrier that must be overcome and either a right of return of assets transferred or a right of release of a promisor's obligation to transfer assets. This update was effective for the University beginning July 1, 2018. The adoption of this guidance did not have a material impact on the consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *"Fair Value Measurement; Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement."* This update modifies the disclosure requirements on fair value measurements in Topic 820, Fair Value Measurement. This update is effective for the University beginning July 1, 2020, with early adoption permitted. The University has not yet evaluated the impact this guidance may have on its consolidated financial statements.

3. LIQUIDITY AND AVAILABILITY OF FINANCIAL ASSETS

The University regularly monitors liquidity required to meet its operating needs and other contractual commitments, while also striving to maximize the investment of its available funds. For purposes of analyzing resources available to meet general expenditures over a 12-month period, the University considers all expenditures related to its ongoing mission-related activities as well as the conduct of services undertaken to support those activities to be general expenditures.

Student loans receivable are not considered to be available to meet general expenditures because principal and interest on these loans are used solely to make new loans.

In addition to financial assets available to meet general expenditures over the next 12 months, the University operates with a balanced budget and anticipates collecting sufficient revenue to cover general expenditures not covered by donor-restricted resources. Refer to the statement of cash flows, which identifies the sources and uses of the University's cash and shows positive cash generated by operations for the year ended June 30, 2019.

The University has various sources of liquidity at its disposal, including cash and cash equivalents and fixed income and equity securities.

The University has designated a portion of its resources without donor restrictions for endowment and other purposes. These funds are invested for long-term appreciation and current income but remain available and may be spent at the discretion of management.

The following reflects the University's financial assets as of the statement of financial position date, reduced by amounts not available for general use within one year. Certain long-term investments could be liquidated if needed based on the terms of their agreements.

(in thousands of dollars)	June 30, 2019
Total assets	$ 15,920,956
Less:	
Inventories	(52,516)
Prepaid expenses and other assets	(137,764)
Total investment in plant, net	(5,588,943)
Beneficial interest in perpetual trusts	(23,898)
Other assets	(177,398)
Total financial assets	9,940,437
Less:	
Noncurrent investments	(6,304,490)
Contractual or donor-imposed restrictions:	
Deposits held by bond trustees	(118,753)
Deposits held for others	(40,587)
Receivables subject to time restrictions	(58,071)
Receivables subject to donor-imposed restrictions	(102,791)
Loans to students, net	(54,096)
Financial assets available to meet cash needs for general expenditures within one year	$ 3,261,649

4. INVESTMENTS

Investments by major category as of June 30 are summarized as follows:

(in thousands of dollars)	2019	2018
Money markets	$ 318,849	$ 183,623
Fixed income:		
U.S. government/agency	941,173	874,684
U.S. corporate	594,125	791,604
Foreign	148,584	202,459
Other	451,674	441,925
Equities	2,198,001	2,135,407
Private capital	2,059,526	1,767,259
Total	$ 6,711,932	$ 6,396,961

Other fixed income investments consist of collateralized mortgage obligations, mortgage-backed securities and asset-backed securities. Equity investments are comprised of domestic and foreign common stocks. Private capital consists primarily of interests in private real estate, venture capital, private equity, natural resources, private debt, commodities and hedge fund limited partnerships.

Futures contracts comprise the University's beneficially held derivative instruments at June 30, 2019 and 2018 and are included in the fair value of the University's investments. These contracts are fully cash collateralized and marked to market daily. The fair value of derivative instruments is included in the fair value of the University's investments within the money market category. Futures contracts have minimal credit risk because the counterparties are the exchanges themselves. Fully cash collateralized derivative securities comprised $4.0 million, or 0.06%, of total investments at June 30, 2019 and 2018. The University's derivatives consist of S&P equity futures at June 30, 2019 and 2018 and are employed as a low cost, passive investment vehicle with daily liquidity which allows the University to maintain desired market exposure in light of irregular cash flows.

The following schedules summarize the investment return and its classification in the consolidated statement of activities for the years ended June 30:

(in thousands of dollars) 2019	Without donor restrictions	With donor restrictions	Total
Investment income	$ 117,557	$ 17,811	$ 135,368
Net realized gains (losses), including endowment spending	87,123	(66,484)	20,639
Net unrealized gains	177,065	130,090	307,155
Total returns	$ 381,745	$ 81,417	$ 463,162

(in thousands of dollars) 2018	Without donor restrictions	With donor Restrictions	Total
Investment income	$ 185,372	$ 15,141	$ 200,513
Net realized gains, including endowment spending	73,428	34,663	108,091
Net unrealized gains	21,192	34,418	55,610
Total returns	$ 279,992	$ 84,222	$ 364,214

5. ENDOWMENT NET ASSETS

The University's endowment includes both donor-restricted endowment funds and funds designated to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The ASC Not-for-Profit Entities Presentation of Financial Statements Subtopic (ASC Subtopic 958-205) provides guidance on the net asset classification of donor-restricted endowment funds for not-for-profit organizations subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") and improves disclosure about an organization's endowment funds regardless of whether the organization is subject to UPMIFA. The Commonwealth of Pennsylvania has not adopted UPMIFA but rather has enacted Pennsylvania Act 141 ("PA Act 141"). PA Act 141 permits an organization's trustees to define income as a stipulated percentage of endowment assets (between 2% and 7% of the fair value of the assets averaged over a period of at least three preceding years) without regard to actual interest, dividend, or realized and unrealized gains.

The University has interpreted PA Act 141 to permit the University to spend the earnings of its endowment based on a total return approach, without regard to the fair value of the original gift. As a result of this interpretation, the University classifies as net assets with donor restrictions the original value of gifts donated to the permanent endowment, the original value of subsequent gifts to the permanent endowment, and 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. Also included in net assets with donor restrictions are gains and losses attributable to permanent endowments and deficiencies associated with funds where the value of the fund has fallen below the original value of the gift. Funds functioning as endowments are established at the direction of University management and are classified as net assets without donor restrictions due to the lack of external donor restrictions. Also included in net assets without donor restrictions are gains and losses attributable to funds functioning as endowments.

From time to time, due to unfavorable market fluctuations, the fair value of some assets associated with individual donor-restricted endowment funds may fall below the level that donors require to be retained as a perpetual fund, while other assets are unaffected to the same extent and maintain or exceed the level required. Such deficiencies are reported as net assets with donor restrictions. As of June 30, 2019 and 2018, funds with an original gift value of $13.0 million and $52.1 million were "underwater" by $2.3 million and $1.4 million, respectively. Subsequent investment gains will be used to restore the balance up to the fair market value of the original gift.

Endowment net asset composition by type of fund as of June 30:

(in thousands of dollars) 2019	Without donor restrictions	With donor restrictions	Total
Donor-restricted endowment funds	$ -	$ 2,278,892	$ 2,278,892
Funds functioning as endowments	860,795	-	860,795
Total net assets	$ 860,795	$ 2,278,892	$ 3,139,687

(in thousands of dollars) 2018	Without donor restrictions	With donor restrictions	Total
Donor-restricted endowment funds	$ -	$ 2,099,675	$ 2,099,675
Funds functioning as endowments	762,836	-	762,836
Total net assets	$ 762,836	$ 2,099,675	$ 2,862,511

Changes in endowment net assets for the years ended June 30:

(in thousands of dollars) 2019	Without donor restrictions	With donor restrictions	Total
Endowment net assets, beginning of the year	$ 762,836	$ 2,099,675	$ 2,862,511
Endowment return, net	143,382	71,869	215,251
Contributions	-	107,348	107,348
Endowment spending	(117,470)	-	(117,470)
Transfers to create funds functioning as endowments	72,047	-	72,047
Endowment net assets, end of the year	$ 860,795	$ 2,278,892	$ 3,139,687

(in thousands of dollars) 2018	Without donor restrictions	With donor restrictions	Total
Endowment net assets, beginning of the year	$ 651,647	$ 1,944,527	$ 2,596,174
Endowment return, net	129,478	70,945	200,423
Contributions	-	84,203	84,203
Endowment spending	(105,183)	-	(105,183)
Transfers to create funds functioning as endowments	86,894	-	86,894
Endowment net assets, end of the year	$ 762,836	$ 2,099,675	$ 2,862,511

Not included above are the endowment net assets of subsidiaries of $32.4 million and $20.2 million as of June 30, 2019 and 2018, respectively.

The University has adopted investment and spending policies for endowment assets that attempt to provide a relatively predictable stream of funding to programs supported by its endowment while seeking to maintain, over time, the purchasing power of the endowment assets. The overall management objective for the University's pooled endowment funds is to preserve or grow the real (inflation-adjusted) purchasing power of the assets through a prudent long-term investment strategy. This objective would be achieved on a total return basis. Under these policies, as approved by the Board of Trustees and the Penn State Investment Council, the primary investment objective of the University's pooled endowment is to attain a real total return (net of investment management fees) that at least equals a total annual effective spending rate of 5.25% (program spending of 4.5% plus administrative costs of 0.75%) over the long term.

To satisfy its long-term rate-of-return objectives, the University 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). The University targets diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints. The endowment assets of the University are invested in a broad range of equities and fixed income securities, thereby limiting the market risk exposure in any one institution or individual investment.

The University has a policy of appropriating for distribution each year a certain percentage (4.5% for 2019 and 2018) of its pooled endowment fund's average fair market value over the prior five years preceding the fiscal year in which the distribution is planned. Accordingly, over the long term, the University expects the current spending policy to allow its endowment to provide generous current spending while preserving "intergenerational equity". This is consistent with the University's objective to maintain the purchasing power of the endowment assets held in perpetuity as well as to provide additional real growth through new gifts and investment returns.

6. FAIR VALUE MEASUREMENTS

The University utilizes the following fair value hierarchy, which prioritizes into three broad levels the inputs to valuation techniques used to measure fair value:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets as of the measurement date. Such instruments valued at Level 1 primarily consist of securities that are directly held and actively traded in public markets.

Level 2 – Inputs other than unadjusted quoted prices that are observable for the asset or liability, directly or indirectly, including quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability, and inputs that are derived from observable market data by correlation or other means.

Level 3 – Unobservable inputs that cannot be corroborated by observable market data.

In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The University's assessment of significance of a particular item to the fair value measurement in its entirety requires judgment, including consideration of inputs specific to the asset.

The following table presents information as of June 30, 2019 about the University's financial assets and liabilities that are measured at fair value on a recurring basis:

(in thousands of dollars)	Quoted Prices in Active Markets For Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total Fair Value
Assets:				
Long-term Investment Pool:				
Money markets	$ 147,569	$ 40,181	$ -	$ 187,750
Fixed income				
U.S. government/agency	-	106,695	-	106,695
U.S. corporate	-	72,121	-	72,121
Foreign	-	60,223	-	60,223
Other	-	86,696	40	86,736
Equities	900,617	4,812	-	905,429
Total	$ 1,048,186	$ 370,728	$ 40	$ 1,418,954
Operating investments:				
Money markets	$ 90,798	$ 40,301	$ -	$ 131,099
Fixed income				
U.S. government/agency	71,951	762,527	-	834,478
U.S. corporate	41,294	480,710	-	522,004
Foreign	4,733	83,628	-	88,361
Other	16,909	347,858	171	364,938
Equities	214,037	2	5,453	219,492
Total	$ 439,722	$ 1,715,026	$ 5,624	$ 2,160,372
Deposits held by bond trustees:				
Money markets	$ 118,753	$ -	$ -	$ 118,753
Beneficial interest in perpetual trusts	$ -	$ -	$ 23,898	$ 23,898
Liabilities:				
Present value of annuities payable	$ -	$ -	$ 57,049	$ 57,049

The following table presents information as of June 30, 2018 about the University's financial assets and liabilities that are measured at fair value on a recurring basis:

(in thousands of dollars)	Quoted Prices in Active Markets For Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total Fair Value
Assets:				
Long-term Investment Pool:				
Money markets	$ 152,310	$ 756	$ -	$ 153,066
Fixed income				
U.S. government/agency	-	86,060	-	86,060
U.S. corporate	-	152,990	-	152,990
Foreign	-	70,523	-	70,523
Other	-	91,022	-	91,022
Equities	914,841	85	-	914,926
Total	$ 1,067,151	$ 401,436	$ -	$ 1,468,587
Operating investments:				
Money markets	$ 30,558	$ -	$ -	$ 30,558
Fixed income				
U.S. government/agency	43,736	744,887	-	788,623
U.S. corporate	79,872	558,742	-	638,614
Foreign	15,023	116,913	-	131,936
Other	29,255	321,648	-	350,903
Equities	158,312	7	5,297	163,616
Total	$ 356,756	$ 1,742,197	$ 5,297	$ 2,104,250
Deposits held by bond trustees:				
Money markets	$ 102,659	$ -	$ -	$ 102,659
Beneficial interest in perpetual trusts	$ -	$ -	$ 23,587	$ 23,587
Liabilities:				
Present value of annuities payable	$ -	$ -	$ 59,236	$ 59,236

The fair value tables above exclude investments of $3,132.6 million and $2,824.1 million as of June 30, 2019 and 2018, respectively, which are measured at net asset value (NAV) per share or its equivalent and are not classified in the fair value hierarchy.

The Long-term Investment Pool (LTIP) is a mutual fund-like vehicle used for investing the University's endowment funds, funds functioning as endowments, and other operating funds that are expected to be held long-term. A share method of accounting for the LTIP is utilized by the University. Each participating fund enters into and withdraws from the LTIP based on monthly share values. At June 30, 2019 and 2018, the fair value of endowment funds and funds functioning as endowments within the LTIP totaled $3,164.9 million and $2,891.7 million, respectively. At June 30, 2019 and 2018, the fair value of operating funds included in the LTIP totaled $1,383.5 million and $1,398.3 million, respectively.

The following tables present information related to changes in Level 3 for each category of financial assets and liabilities for year ended June 30, 2019:

(in thousands of dollars)	Operating Investments	Long Term Investment Pool	Beneficial Interest in Perpetual Trusts
Assets:			
Beginning balance	$ 5,297	$ -	$ 23,587
Total realized and unrealized gains	156	-	311
Purchases	171	40	-
Ending balance	$ 5,624	$ 40	$ 23,898

	Present Value of Annuities Payable
Liabilities:	
Beginning balance	$ 59,236
Actuarial adjustment of liability	1,129
Gifts	279
Sales	(3,595)
Ending balance	$ 57,049

The following tables present information related to changes in Level 3 for each category of financial assets and liabilities for year ended June 30, 2018:

(in thousands of dollars)	Operating Investments	Beneficial Interest in Perpetual Trusts
Assets:		
Beginning balance	$ 4,688	$ 19,854
Total realized and unrealized gains	602	3,651
Gifts	-	82
Purchases	7	-
Ending balance	$ 5,297	$ 23,587

	Present Value of Annuities Payable
Liabilities:	
Beginning balance	$ 58,070
Actuarial adjustment of liability	2,255
Gifts	986
Sales	(2,075)
Ending balance	$ 59,236

There were no transfers of assets between Level 3 and Level 2 and between Level 1 and Level 2 in 2019 and 2018.

The following table presents the fair value and redemption frequency for those investments whose fair value is not readily determinable and is estimated using NAV or its equivalent as of June 30, 2019 and 2018:

(in thousands of dollars)	Fair Value 2019	Fair Value 2018	Unfunded Commitments At June 30, 2019	Redemption Frequency	Redemption Notice Period
Commingled Funds:					
U.S. Equity	$ 262,664	$ -		Monthly	30 days
Non-U.S. Equity	693,701	927,415		Quarterly/ Daily/Monthly	5-90 days
Subtotal	$ 956,365	$ 927,415			
Marketable Investment Partnerships:					
Absolute Return	$ 61,895	$ 59,528		Quarterly	60 days
Distressed Debt	54,518	54,317		Quarterly/ Semi Annual	60-90 days
Commodities	70,711	82,833		Monthly	30-60 days
Opportunistic	291,267	268,806		Monthly/ Quarterly/ Annually	30-90 days
Directional Long/Short	288,072	303,068		Monthly	30 days
Subtotal	$ 766,463	$ 768,552			
Non-Marketable Investment Partnerships:					
Private Real Estate	$ 56,782	$ 66,430	$ 89,968		
Venture Capital	530,760	383,882	182,207		
Private Equity	500,739	390,952	309,196		
Natural Resources	133,764	142,396	58,005		
Private Debt	187,733	144,497	236,252		
Subtotal	$ 1,409,778	$ 1,128,157	$ 875,628		
Total	$ 3,132,606	$ 2,824,124	$ 875,628		

Commingled Funds include investments that aggregate assets from multiple investors and are managed collectively following a prescribed strategy. Redemptions vary from daily to quarterly with required notification of 90 days or less. U.S. equity strategies aim to diversify sources of return by investing in various U.S. equity vehicles. The non-U.S. equity strategy is invested in developed and developing countries outside of the United States and spans the entire equity capitalization spectrum. These collective portfolios preclude the need to obtain securities registration in foreign countries.

Marketable Investment Partnerships include several hedge funds whose underlying positions are traded via public securities markets. Liquidity terms range from quarterly to annually with advance notification for redemption ranging from 30 to 90 days. The fair values of the investments for each fund in this category have been estimated using the net asset value of the LTIP's share holdings in the fund. Five major investment strategies are included within this category. Absolute Return refers to relative value strategies. Distressed Debt refers to securities rated below investment grade, along with non-rated debt. Commodities refer to publicly traded commodity instruments primarily including futures and options. Opportunistic refers to global multi-strategy. Directional refers to equity long/short strategies in both U.S. and non-U.S. markets.

Non-Marketable Investment Partnerships include limited partnership interests in a variety of illiquid investments. The fair values of the investments for each fund in this category have been estimated using the net asset value of the LTIP's ownership interest in partner's capital and cannot be redeemed. Realizations from each fund are received as the underlying investments are liquidated or distributed, typically within 10 years after initial commitment. Unfunded commitments represent remaining commitments of the LTIP's drawdown funds as of June 30, 2019. Five major investment strategies are included within this category.

Private Real Estate includes properties primarily located in the U.S. Venture Capital includes non-public startups and enterprises in early stages of growth located globally. Private Equity includes buyouts of previously public companies as well as enterprises that are planning to go public in the near future, including funds focusing on opportunities outside the U.S. Natural Resources largely include companies primarily involved in oil and natural gas in addition to a variety of other natural resources. Private Debt includes global private credit securities rated below investment grade as well as non-rated debt.

7. CONTRIBUTIONS RECEIVABLE

Contributions receivable are summarized as follows as of June 30:

(in thousands of dollars)	2019	2018
In one year or less	$ 47,135	$ 69,963
Between one year and five years	75,687	70,295
More than five years	112,164	114,750
Contributions receivable, gross	234,986	255,008
Less allowance	(5,723)	(6,427)
Less discount	(49,733)	(52,096)
Contributions receivable, net	$ 179,530	$ 196,485

Contributions received during the years ended June 30, 2019 and 2018 are discounted at rates ranging from 1.71% to 2.15% and 2.33% to 2.90%, respectively. The discount rates for prior periods ranged from 0.11% to 6.28%.

At June 30, 2019 and 2018, the University has received bequest intentions of $606.3 million and $546.2 million, respectively, and certain other conditional promises to give of $50.5 million and $30.7 million, respectively. These intentions and conditional promises to give are not included in the consolidated financial statements.

The following table summarizes the change in contributions receivable, net during the year ended June 30, 2019:

	(in thousands of dollars)
Balance at the beginning of year	$ 196,485
New pledges	68,206
Collections on pledges	(60,657)
Correction to remove certain conditional pledges	(27,571)
Decrease in allowance	704
Decrease in unamortized discounts	2,363
Balance at the end of year	$ 179,530

In preparing the 2019 financial statements, the University identified and corrected an out of period error related to certain conditional contributions that had been previously recognized as unconditional contributions. As such, contributions receivable in the accompanying consolidated statement of financial position as of June 30, 2019, and gifts and pledges with donor restrictions in the accompanying consolidated statement of activities for the year ended June 30, 2019 have been reduced by $27.6 million, respectively, to correct this out of period error. In addition, the University determined that its previously reported conditional promises to give of approximately $104.6 million as of June 30, 2018 were understated by approximately $472.3 million. As such, the bequest intentions amounts disclosed above as of June 30, 2018 has been revised to correct the previously reported amount. The University has not revised its previously reported consolidated financial statements for the correction of the foregoing errors based on the belief that the effect of such errors is not material.

8. LONG-TERM DEBT

The various bond issues, notes payable and capital lease obligations that are included in long-term debt in the statements of financial position consist of the following at June 30:

(in thousands of dollars)	2019	2018
The Pennsylvania State University Bonds		
Series 2019A	$ 107,000	$ -
Series 2019B	119,000	-
Series 2018	64,210	64,210
Series 2017A	154,680	157,080
Series 2017B	122,340	125,000
Series 2016A	116,890	119,580
Series 2016B	211,980	221,480
Series 2015A	60,800	62,320
Series 2015B	100,515	104,335
Series 2010	123,625	127,580
Series 2009B	74,235	74,235
Series 2007B	43,835	47,545
Pennsylvania Higher Educational Facilities Authority University Revenue Bonds (issued for The Pennsylvania State University)		
Series 2006	2,155	2,410
Series 2004	2,230	2,540
Series 2002	1,530	1,995
Lycoming County Authority College Revenue Bonds (issued for Penn College)		
Series 2016	50,675	52,465
Series 2015	3,440	5,030
Series 2012	22,175	23,255
Series 2011	37,655	37,735
Total bonds payable	1,418,970	1,228,795
Unamortized bond premiums	164,003	146,254
Unamortized deferred bond costs	(6,504)	(5,981)
Notes payable and capital leases		
Notes payable	21,366	24,632
Capital lease obligations	52,817	56,477
Total notes payable and capital leases	74,183	81,109
Total long-term debt	$ 1,650,652	$ 1,450,177

Debt issuance	Interest rate mode	Interest rates	Payment ranges and maturity *(in thousands of dollars)*
The Pennsylvania State University Bonds			
Series 2019A	Fixed	5.00%	$1,575 to $6,720 through September 2049
Series 2019B	Fixed	2.05% - 3.50%	$2,555 to $3,720 through September 2034 with $20,455 and $52,515 due September 2039 and September 2049, respectively
Series 2018	Fixed	2.00% - 5.00%	$975 to $2,320 through September 2037 with $16,650 and $18,255 due September 2043 and September 2048, respectively
Series 2017A	Fixed	2.00% - 5.00%	$2,510 to $5,965 through September 2037 with $34,750 and $44,620 due September 2042 and September 2047, respectively
Series 2017B	Fixed	1.477% - 3.793%	$2,695 to $3,830 through September 2032 with $21,305 and $56,595 due September 2037 and September 2047, respectively
Series 2016A	Fixed	5.00%	$2,820 to $6,465 through September 2036 with $37,520 due September 2041
Series 2016B	Fixed	4.00% - 5.00%	$7,165 to $22,195 through September 2036
Series 2015A	Fixed	5.00%	$1,580 to $3,445 through September 2035 with $20,000 due September 2040
Series 2015B	Fixed	5.00%	$3,975 to $8,435 through September 2035
Series 2010	Fixed	3.375% - 5.00%	$4,115 to $6,595 through March 2030 with $21,805 and $44,245 due March 2035 and March 2040, respectively
Series 2009B	Variable	1.58%	June 2031
Series 2007B	Fixed	5.25%	$3,910 to $5,955 through August 2027
Pennsylvania Higher Educational Facilities Authority (“PHEFA”) University Revenue Bonds			
Series 2006	Fixed	4.375% - 5.125%*	$265 to $280 through September 2020 with $1,610 due September 2025
Series 2004	Fixed	4.80% - 5.00%*	$325 due September 2019 and $1,905 due September 2024
Series 2002	Fixed	5.00%*	$2,435 due March 2022

*Annual interest costs to the University for interest rates greater than 3.00% are subsidized by PHEFA.

Lycoming County Authority College Revenue Bonds			
Series 2016	Fixed	2.125% - 5.00%	$1,855 to $3,615 through October 2032 with $19,345 due October 2037
Series 2015	Fixed	2.50% - 4.00%	$465 to $625 through January 2025
Series 2012	Fixed	2.50% - 5.00%	$1,170 due May 2020 with $2,565, $6,395 and $12,045 due May 2022, May 2026 and May 2032, respectively
Series 2011	Fixed	4.00% - 5.24%	$1,565 to $1,850 through July 2021 with $14,170 and $18,705 due July 2026 and July 2030, respectively

The Series 2019A Bonds are general obligation bonds issued in June 2019 for the purpose of financing various construction and renovation projects. The Series 2019A Bonds are subject to early redemption provisions, at the option of the University, beginning September 2029.

The Series 2019B Bonds are taxable general obligation bonds issued in June 2019 for the purpose of financing the general corporate purposes of the University. The Series 2019B Bonds are subject to early redemption provisions, at the option of the University, in order of their maturity, at the make-whole redemption price. The bonds maturing in September 2039 and September 2049 are subject to mandatory sinking fund redemption.

The Series 2009B Bonds are currently paying interest on a variable rate basis at a long-term rate for the period June 1, 2019 through May 31, 2020. The University has the option to convert to another variable rate (daily, weekly, monthly or flexible) or to a fixed rate basis (such rates are generally determined on a market basis) at respective conversion dates. The bonds currently pay interest at 1.58% with adjustment on the respective date to the rate the remarketing agent believes will cause the bonds to have a market value equal to the principal. The 2009B bondholders have the right to tender bonds on the purchase dates while such bonds bear interest at the daily, weekly or monthly rate. The 2009B Bonds were issued subject to the self-liquidity program established by the University on the date of issuance pursuant to which the University will provide liquidity for the 2009B Bonds from its general funds in the event of insufficient remarketing proceeds.

The University has complied with all financial debt covenants for the years ended June 30, 2019 and 2018.

Maturities and sinking fund requirements on bonds payable for each of the next five fiscal years and thereafter are summarized as follows:

Year	Annual Installments *(in thousands of dollars)*
2020	$ 38,760
2021	44,605
2022	46,655
2023	48,790
2024	50,965
Thereafter	1,189,195
	$ 1,418,970

The fair value of the University's bonds payable is estimated based on current rates offered for similar issues with similar security, terms and maturities using available market information as supplied by the various financial institutions who act as trustees or custodians for the University. At June 30, 2019, the carrying value and estimated fair value of the University's bonds payable, including issuance premiums and deferred bond costs, are $1,576.5 million and $1,596.8 million, respectively. At June 30, 2018, the carrying value and estimated fair value of the University's bonds payable, including issuance premiums and deferred bond costs, were $1,369.1 million and $1,347.6 million, respectively. Certain bond issues have associated issuance premiums; these issuance premiums total $164.0 million and $146.3 million at June 30, 2019 and 2018, respectively, and are presented within the statement of financial position as long-term debt. These issuance premiums will be amortized over the term of the respective outstanding bonds. Certain bond issues have associated deferred bond costs; these deferred bond costs total $6.5 million and $6.0 million at June 30, 2019 and 2018, respectively, and are presented within the statement of financial position as a reduction in long-term debt. These deferred bond costs will be amortized over the term of the respective outstanding bonds.

Notes payable and capital leases

The University has three notes payable included within the consolidated statements of financial position at June 30, 2019 with balances of $5.8 million, $7.0 million, and $8.6 million. These notes have payments due annually through June 2024, June 2025, and March 2026 and bear interest at 2.60%, 2.85%, and 2.80%, respectively. The current portion of payments due under these notes totals $3.4 million at June 30, 2019.

The University has certain building and equipment lease agreements in effect which are considered capital leases. Future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of June 30, 2019 are as follows:

Year	(in thousands of dollars)
2020	$ 13,013
2021	10,590
2022	7,133
2023	5,593
2024	4,504
Thereafter	26,764
Total minimum lease payments	67,597
Less imputed interest	(14,780)
Capital lease obligation	52,817
Current portion	10,956
Long-term portion	$ 41,861

9. OPERATING LEASES

The University has certain lease agreements in effect which are considered operating leases. During the year ended June 30, 2019, the University recorded expenses of $22.6 million for leased equipment and $37.7 million for leased building space. During the year ended June 30, 2018, the University recorded expenses of $22.1 million for leased equipment and $31.1 million for leased building space.

Future minimum lease payments under operating leases as of June 30, 2019 are as follows:

Year	(in thousands of dollars)
2020	$ 27,625
2021	19,921
2022	15,452
2023	12,076
2024	11,189
Thereafter	46,334
Total minimum lease payments	$ 132,597

10. FUNCTIONAL AND NATURAL CLASSIFICATION OF EXPENSES

Functional expenses by natural classification as of June 30, 2019 are as follows:

(in thousands of dollars)	Educational and General	Auxiliary Enterprises	Health System	Total
Salaries and wages	$ 1,693,149	$ 108,831	$ 1,110,763	$ 2,912,743
Benefits	539,695	55,855	285,459	881,009
Depreciation	272,561	38,203	101,813	412,577
Plant operations and maintenance	150,493	19,585	47,789	217,867
Other components of net periodic postretirement benefit cost	96,344	628	-	96,972
Interest	24,599	23,031	11,902	59,532
Supplies, services, and other	732,797	219,789	843,775	1,796,361
Total	$ 3,509,638	$ 465,922	$ 2,401,501	$ 6,377,061

Total expenses by natural classification as of June 30, 2018 are as follows:

(in thousands of dollars)

	Total
Salaries and wages	$ 2,715,225
Benefits	830,737
Depreciation	371,570
Plant operations and maintenance	218,044
Other components of net periodic postretirement benefit cost	129,320
Interest	55,402
Supplies, services, and other	1,607,358
Total	$ 5,927,656

The costs of plant operations and maintenance, depreciation, and interest have been allocated across all functional expense categories to reflect the full cost of those activities. Plant operations and maintenance and depreciation expense are allocated based on the total proportionate expenses of each functional classification. Interest expense is allocated based on the proportionate share of total debt-financed construction.

11. RETIREMENT BENEFITS

The University provides retirement benefits for substantially all regular employees, primarily through either contributory defined benefit plans administered by the Commonwealth of Pennsylvania State Employees' Retirement System (“SERS”) and The Public School Employees' Retirement System or defined contribution plans administered by the Teachers Insurance and Annuity Association. The University is billed for its share of the estimated actuarial cost of the defined benefit plans ($125.8 million and $121.0 million for the years ended June 30, 2019 and 2018, respectively). The Health System provides retirement benefits for substantially all employees through one of three defined contribution plans administered by Empower Retirement. The University’s total cost for retirement benefits, included in expenses, is $285.2 million and $269.7 million for the years ended June 30, 2019 and 2018, respectively.

The SERS is the administrator of a cost-sharing, multi-employer retirement system established by the Commonwealth of Pennsylvania to provide pension benefits for employees of state government and certain independent agencies. As provided by statute, the SERS Board of Trustees has exclusive control and management responsibility of the funds and full power to invest the funds. The SERS funding policy provides for periodic member contributions at statutory rates and employer contributions at actuarially determined rates (expressed as a percentage of annual gross pay) that are sufficient to accumulate assets to pay benefits when due. The University’s contributions to this plan for the years ended June 30, 2019 and 2018 were $122.7 million and $118.2 million, respectively, and represent approximately 6.0% of total contributions to the plan based on projections for fiscal year 2019. The plan is funded at less than 65% with the funded ratio of the plan at 56.0% as of December 31, 2018.

12. POSTRETIREMENT BENEFITS

The University sponsors a retiree medical plan covering eligible retirees and eligible dependents. This program includes a Preferred Provider Organization (“PPO”) plan (both a traditional and a qualified high deductible option) for retirees and their dependents who are not eligible for Medicare, and a Medicare Advantage PPO plan. In addition, the University provides certain retiree life insurance benefits to eligible retirees as described below.

Employees who were hired prior to January 1, 2010 are eligible for medical coverage after they retire if either of the following requirements are satisfied:

- they are at least age 60 and have at least 15 years of continuous regular full-time employment and participation in a University-sponsored medical plan immediately preceding the retirement date

- regardless of age, if they have at least 25 years of regular full-time service. The last 10 of those 25 years of University service must be continuous and they must participate in a University-sponsored medical plan during the last 10 years immediately preceding the retirement date.

Effective January 1, 2016, any non-union employee who retires on or before December 31, 2020 will receive a $5,000 term life insurance policy benefit at no cost to the employee. If a non-union employee retires after December 31, 2020, no life insurance benefit is provided. For union employees, a $5,000 term life insurance policy is provided at no cost to the employee regardless of their retirement date.

The retiree PPO medical plan is a self-funded program, and all medical claims and other expenses are paid from net assets without donor restrictions of the University. The Medicare Advantage PPO plan and life insurance program are fully-insured. The retirees pay varying amounts for coverage under the medical plan.

For those employees who were hired after December 31, 2009, the University will contribute funds each month on their behalf to a Retirement Healthcare Savings Plan. This plan is designed to help pay for qualified medical and health-related expenses in retirement, including the purchase of a health insurance policy.

Retirees will be eligible to access their Retirement Healthcare Savings Plan account when they are no longer actively employed at Penn State and have satisfied either of the following requirements:

- completed 25 years of continuous full-time service and are age 60 or older
- completed a minimum of 15 years of continuous full-time service and are age 65 or older.

Included in net assets without donor restrictions at June 30, 2019 and 2018 are the following amounts that have not yet been recognized in net periodic postretirement cost: unrecognized prior service cost (benefit) of ($2.5) million and ($4.1) million and unrecognized actuarial loss of $396.9 million and $459.7 million, respectively.

The following sets forth the plan's benefit obligation, plan assets and funded status reconciled with the amounts recognized in the University's consolidated statements of financial position at June 30:

Change in benefit obligation:
(in thousands of dollars)

	2019	2018
Benefit obligation at beginning of year	$ 2,193,555	$ 2,318,462
Service cost	41,329	47,477
Interest cost	89,066	92,448
Actuarial gain	(171,326)	(95,091)
Benefits paid	(46,617)	(58,199)
Plan amendment	-	1,312
Plan assumptions	118,028	(112,854)
Benefit obligation at end of year	$ 2,224,035	$ 2,193,555

Change in plan assets:
(in thousands of dollars)

	2019	2018
Fair value of plan assets at beginning of year	$ -	$ -
Employer contributions	46,617	58,199
Benefits paid	(46,617)	(58,199)
Fair value of plan assets at end of year	$ -	$ -
Funded status	$ (2,224,035)	$ (2,193,555)
Unrecognized prior service cost (benefit)	-	-
Unrecognized net actuarial loss	-	-
Accrued postretirement benefit expense	$ (2,224,035)	$ (2,193,555)

Net periodic postretirement cost includes the following components for the years ended June 30:
(in thousands of dollars)

	2019	2018
Operating expenses:		
Service cost	$ 41,329	$ 47,477
Nonoperating activities:		
Interest cost	89,066	92,448
Amortization of prior service cost	(1,574)	(3,131)
Amortization of unrecognized net loss	9,480	40,003
Net periodic postretirement cost	$ 138,301	$ 176,797

The assumed healthcare cost trend rate used in measuring the accumulated postretirement benefit obligation was 6.90% and 7.20% for the years ended June 30, 2019 and 2018, respectively, reduced each year to an ultimate level of 5.00%. The postretirement benefit obligation discount rate was 3.92% and 4.46% for the years ended June 30, 2019 and 2018, respectively. During 2019, the plan had favorable claims experience compared to assumptions and positive results related to the change in the mortality table and improvement scale. During 2018, the plan had favorable demographic experience compared to assumptions. In addition, the plan had positive per capita medical claims experience over the past 3 years contributing to favorable results during 2018.

If the healthcare cost trend rate assumptions were increased by 1% in each year, the accumulated postretirement benefit obligation would be increased by $461.6 million and $452.6 million as of June 30, 2019 and 2018, respectively. The effect of this change on the sum of the service cost and interest cost components of the net periodic postretirement benefit cost would be an increase of $30.8 million and $34.2 million as of June 30, 2019 and 2018, respectively. If the healthcare cost trend rate assumptions were decreased by 1% in each year, the accumulated postretirement benefit obligation would be decreased by $367.7 million and $348.3 million as of June 30, 2019 and 2018, respectively. The effect of this change on the sum of the service cost and interest cost components of the net periodic postretirement benefit cost would be a decrease of $23.3 million and $25.7 million as of June 30, 2019 and 2018, respectively.

Gains and losses in excess of 10% of the accumulated postretirement benefit obligation are amortized over the average future service to assumed retirement of active participants.

Postretirement benefits expected to be paid for the years ended June 30 are as follows:

	(in thousands of dollars)
2020	$ 57,457
2021	62,212
2022	66,950
2023	72,001
2024	77,291
2025-29	457,061

13. PENN STATE HEALTH

Penn State Health was organized exclusively for the charitable, educational, and scientific purposes as defined and limited by Section 501(c)(3) of the Internal Revenue Code of 1986. The Health System's purpose is to promote, support and further the charitable, educational, and scientific purposes of the University. The Health System is controlled by the University with a minority ownership by Highmark Health.

The wholly owned subsidiaries of the Health System include the Milton S. Hershey Medical Center ("MSHMC"), Saint Joseph's Regional Health Network and Medical Group ("SJRHN/SJMG"), Penn State Community Medical Group ("PSCMG"), Nittany Health, Inc. ("Nittany"), Central PA Health Network ("CIN") and Hampden Medical Center ("Hampden").

In July 2015, the Health System acquired SJRHN/SJMG. SJRHN/SJMG is a 180-bed, not-for-profit acute care hospital that provides inpatient, outpatient, and emergency care services to the Berks County Region.

In January 2016, the ownership of Nittany transferred from the University to the Health System. Nittany (formerly Penn State Hershey Health System, Inc.) is a corporate investor in healthcare joint ventures, which are supportive of the missions of the Health System. Nittany's objectives are consistent with the strategic objective to extend the range of healthcare services offered by and through the Health System over a broader geographic region. Nittany recorded non-controlling interest related to the acquisition of additional ownership interest in a joint venture. This non-controlling interest is recorded in net assets without donor restrictions within the consolidated statements of financial position with a value at June 30, 2019 and 2018 of $2.1 million and $1.9 million, respectively.

In May 2016, the ownership of MSHMC transferred from the University to the Health System. At June 30, 2019, MSHMC is a 548-bed, not-for-profit acute care, academic medical center located in Hershey, Pennsylvania. The University retains ownership of the buildings and land occupied by MSHMC, which is co-located with the University's College of Medicine. The clinical facilities of the Medical Center complex are leased to MSHMC. MSHMC makes certain payments to support the College of Medicine. MSHMC is a Level 1 Regional Trauma Center and provides inpatient, outpatient, and emergency care services to residents of central Pennsylvania through its central facility in Hershey and 35 medical group sites. Additionally, MSHMC operates an ambulatory surgical center, which provides endoscopy procedures to the Centre County Region.

In February 2017, the Health System established PSCMG. The purpose of PSCMG is to extend the ambulatory clinical footprint of the Health System into a broader geographic region. In October 2017, the Health System, through an asset purchase agreement, began operations of 18 medical group sites. During 2019, 5 additional clinic sites were acquired.

In July 2017, CIN ownership was transferred from joint ownership by MSHMC and SJRHN/SJMG to direct ownership by the Health System. The purpose of CIN is to develop population health initiatives across the Health System organization.

In October 2017, the Health System established Hampden (formerly 4814 Development Assoc., Inc.). The purpose of Hampden was to acquire property in Cumberland County, which is intended to be the future site of an acute care hospital. The land acquisition took place in October 2017.

In March 2018, the Health System formed LPADC ("LPADC"). The purpose of LPADC was to acquire property in Lancaster County, which is intended to be the future site of an acute care hospital and medical office building. The land acquisition took place in July 2019.

In January 2018, Highmark Health purchased a 20% minority interest in the Health System. The Health System received cash contributions of $200.0 million in exchange for three board seats and certain reserve powers. The contributions are recorded as capital contributions within non-controlling interest on the statement of activities for the year ended June 30, 2018. Additionally, the Health System recorded non-controlling interest, excess of revenues over expenses, related to this minority interest. The total non-controlling interest related to Highmark Health is recorded in net assets without donor restrictions within the consolidated statements of financial position with a value at June 30, 2019 and 2018 of $250.1 million and $221.7 million, respectively.

During 2019 and 2018, the Health System received cash contributions related to the Community Health Reinvestment Act from Highmark Health. The cash contributions of $30.0 million are recorded as Health System revenue on the consolidated statements of activities. Additionally, during 2019 and 2018, the Health System paid Highmark Health $161.6 million and $146.3 million, respectively, related to employee benefit expenses and recorded $577.5 million and $544.0 million, respectively, in net patient revenue related to Highmark Health Third Party Payor contracts.

14. CONTINGENCIES AND COMMITMENTS

Contractual Obligations

The University has contractual obligations for the construction of new buildings and for additions to existing buildings in the amount of $1,279.9 million, of which $1,055.7 million has been paid or accrued as of June 30, 2019. The contract costs are being financed from available resources and from borrowings.

Letters of Credit

The University has available letters of credit in the amount of $37.8 million and $31.8 million as of June 30, 2019 and 2018, respectively. These letters of credit are used primarily to comply with minimum state and federal regulatory laws that govern various University activities. The fair value of these letters of credit approximates contract values based on the nature of the fee arrangements with the issuing banks.

Guarantees

The University has a contract with a third party whereby the third party acts as an agent of the University in connection with procurement of electricity. The University guarantees the payment of the obligations of the third party incurred on behalf of the University to counterparties.

Self-Insurance

The University has a coordinated program of commercial and self-insurance for medical malpractice claims at MSHMC through the use of a qualified trust and a domestic captive insurance company in combination with a self-insured retention layer and is supplementing this program through participation in the Pennsylvania Medical Care Availability and Reduction of Error Fund (“MCARE Fund”), in accordance with Pennsylvania law. An estimate of the present value, discounted at 2% for the years ended June 30, 2019 and 2018, of the medical malpractice claims liability in the amount of $166.3 million and $131.1 million is recorded as of June 30, 2019 and 2018, respectively.

The subsidiaries of the Health System are self-insured for all medical malpractice claims asserted on or after July 1, 2003, for all amounts that are below the coverage of excess insurance policies and not included in the insurance coverage of the MCARE Fund. Under the self-insurance program, the Health System is required to maintain a malpractice trust fund in an amount at least equal to the expected loss of known claims. The balance of this trust fund was $32.1 million and $31.5 million at June 30, 2019 and 2018, respectively. The Health System intends to fund any claims due during the next year from cash flows from operations.

With approval from the Pennsylvania Department of Labor and Industry (“PA-DLI”), the University elected to self-insure potential obligations applicable to Pennsylvania workers' compensation. Certain claims under the program are contractually administered by a private agency. The University purchased insurance coverage for excess obligations over $600,000 per incident. An estimate of the self-insured workers' compensation claims liability in the amount of $7.2 million and $6.8 million, discounted at 1.76% and 2.73%, respectively, is recorded as of June 30, 2019 and 2018, respectively. The University has established a trust fund, in the amount of $13.8 million and $13.2 million at June 30, 2019 and 2018, respectively, as required by PA-DLI, to provide for the payment of claims under this self-insurance program. The Health System is self-insured for workers’ compensation claims and has purchased excess policies through commercial insurers which cover individual claims in excess of $750,000 per incident for workers’ compensation claims.

The University and the Health System are self-insured for certain health care benefits provided to employees. The University, MSHMC and SJRHN/SJMG have purchased excess policies which cover employee health benefit claims in excess of $600,000, $575,000 and $375,000 per employee per year, respectively. The University and the Health System provide for reported claims and claims incurred but not reported.

Litigation and Contingencies

In November 2011, the University was made aware of certain allegations in a Commonwealth of Pennsylvania Grand Jury presentment. Various legal proceedings and investigations have arisen as a result of such allegations, including criminal proceedings against former officers and employees of the

University. Certain claims and civil litigation have been filed against the University with anticipation that other complaints could be filed. The University has recognized an expense of $0.1 million and $4.0 million for the years ended June 30, 2019 and 2018, respectively, with such amounts included in institutional support within the consolidated statement of activities. Additional claims could be paid in the future but without having knowledge of the number and nature of such claims the University is unable to predict the outcome of these matters or the ultimate legal and financial liability and at this time cannot reasonably estimate the possible loss or range of loss. Accordingly, no amounts have been accrued in the financial statements for these claims.

In addition to the settlement costs, the University has incurred costs for the fiscal years ended June 30, 2019 and 2018 totaling $2.8 million and $3.5 million, respectively, for internal investigation, legal, communications and other related costs. These costs are included in institutional support within the consolidated statement of activities.

The University has submitted claims to insurance carriers related to the claims that have been settled or paid. Some insurance claims have been paid and other insurance claims remain outstanding.

Based on its operation of the Health System (see Note 13), the University, like the rest of the healthcare industry, is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations can be subject to government review and interpretation, as well as regulatory actions. Recently, government reviews of healthcare providers for compliance with regulations have increased. Although the University believes it has done its best to comply with these numerous regulations, such government reviews could result in significant repayments of previously billed and collected revenues from patient services.

Various other legal proceedings have arisen in the normal course of conducting University business. The outcome of such litigation is not expected to have a material effect on the financial position of the University.

15. SUBSEQUENT EVENTS

The University has evaluated subsequent events through October 25, 2019, the date on which the consolidated financial statements were issued. It did not identify any subsequent events to be disclosed other than those below or previously noted.