PENNSTATE

Joseph J. Doncsecz
Corporate Controller

The Pennsylvania State University
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Document Control Desk
USNRC
Washington, DC 20555

Subject: The Pennsylvania State University 2010 Audited Financial Statements and Self Guarantee Financial Test Data

Reference: The Pennsylvania State University Breazeale Nuclear Reactor Docket No. 50-005, License No. R-2

Attached please find the The Pennsylvania State University 2010 Audited Financial Statements.

I hereby certify that the University is currently a going concern, and that it possesses positive tangible net worth in the amount of $4,980,996,000 at June 30, 2010.

The fiscal year of the University ends on June 30.

The University satisfies the following self-guarantee test from 10 CFR 30 Appendix E:

As of June 30, 2010 and the date of this letter the bond rating of the most recent uninsured, uncollateralized, and unencumbered issuance of this institution is Aa1.
Name of Rating Service: Moody's Investors Service
Date of issuance of bond: May 20, 2010
Date of final maturity of bond: March 1, 2040

I declare under penalty of perjury that the foregoing is true and correct.

Executed on December 21, 2010.

Joseph J. Doncsecz

Cc: William Kennedy NRC
Kenan Ünlü, Director, Radiation Science and Engineering Center
Eric Boeldt, Radiation Safety Officer

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Audited Financial Statements

The Pennsylvania State University
Fiscal Year Ended June 30, 2010

THE PENNSYLVANIA STATE UNIVERSITY

UNIVERSITY OFFICERS
as of October 18, 2010

GRAHAM B. SPANIER
President

RODNEY A. ERICKSON
Executive Vice President and
Provost

ALBERT G. HORVATH
Senior Vice President for
Finance and Business, and Treasurer

RODNEY P. KIRSCH
Senior Vice President for Development
and Alumni Relations

HAROLD L. PAZ
Chief Executive Officer, Penn State Milton S.
Hershey Medical Center; Senior
Vice President for Health Affairs; and
Dean, Penn State College of Medicine

THE PENNSYLVANIA STATE UNIVERSITY

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VIRTUE LIBERTY AND INDEPENDENCE

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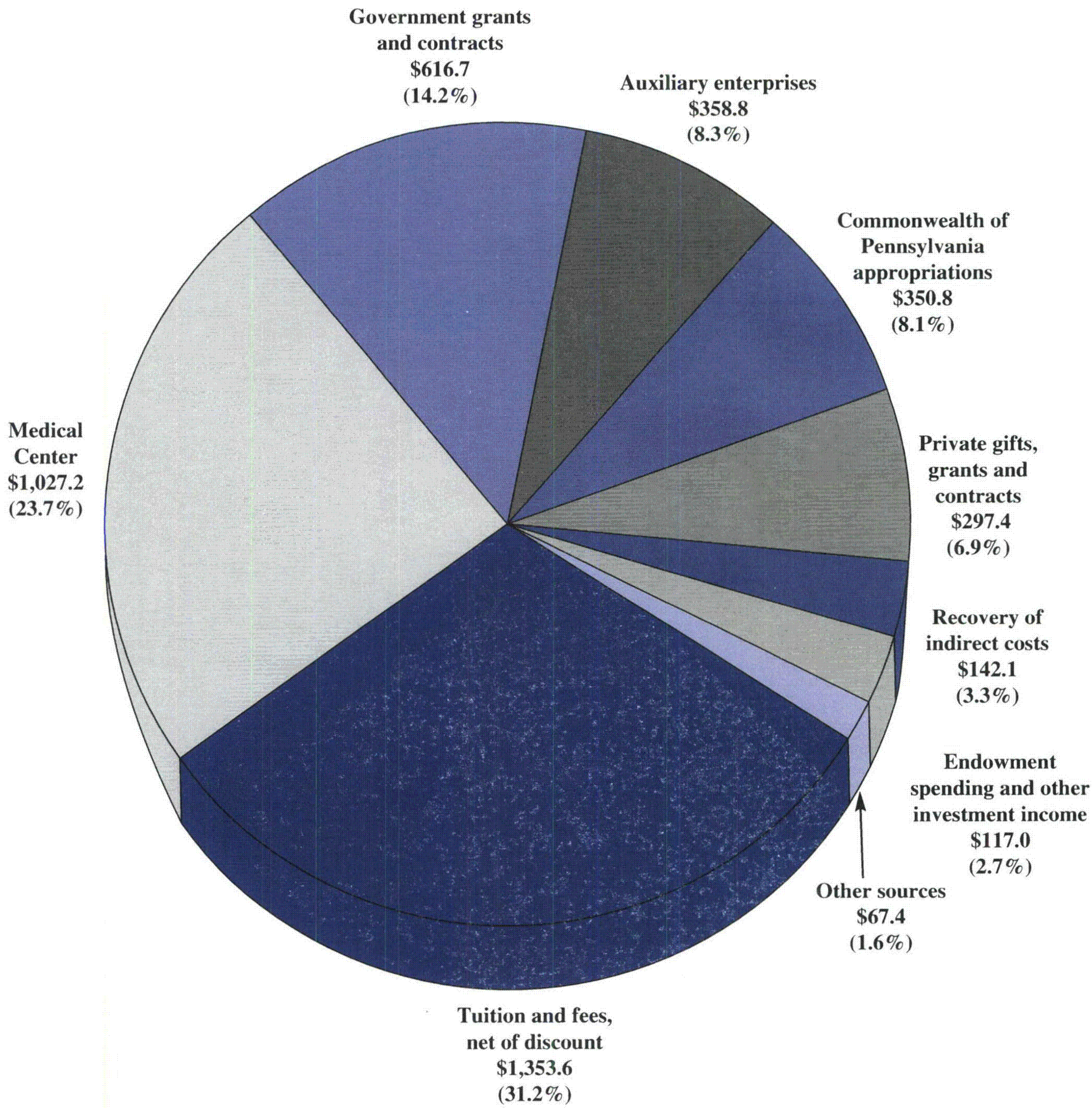
OPERATING REVENUES BY SOURCE ($4.3 billion)

For the Year Ended June 30, 2010

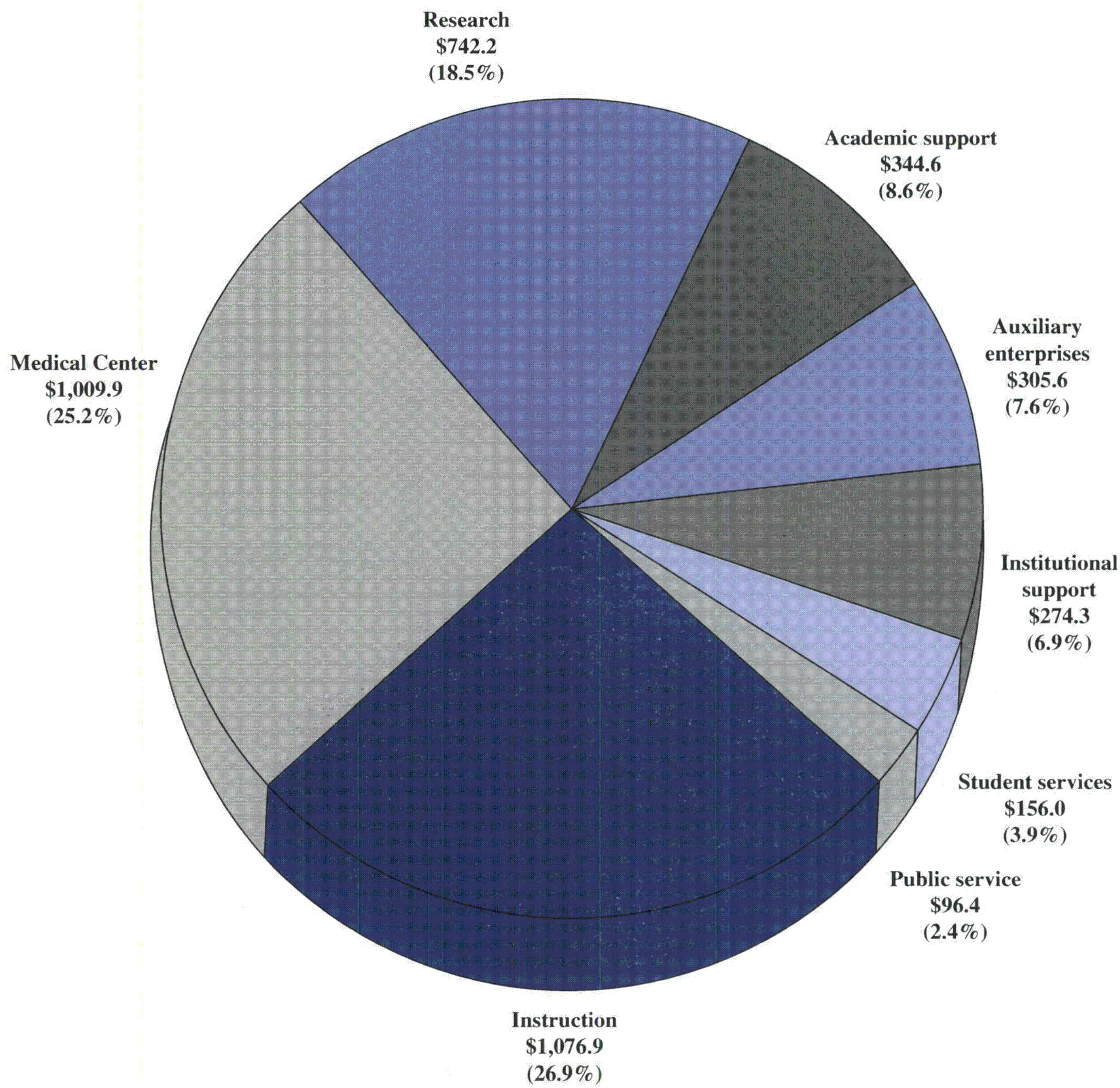
($ in Millions)



OPERATING EXPENSES BY FUNCTION ($4.0 billion)

For the Year Ended June 30, 2010

($ in Millions)



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814-865-1355
Fax: 814-863-0701

October 18, 2010

Dr. Graham Spanier, President
The Pennsylvania State University

Dear Dr. Spanier:

The audited consolidated financial statements of The Pennsylvania State University and subsidiaries (the "University") for the fiscal year ended June 30, 2010 are presented on the accompanying pages. These financial statements represent a complete and permanent record of the finances of the University for the year.

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
Corporate Controller

Albert G. Horvath
Senior Vice President for Finance & Business/Treasurer

Deloitte.

Deloitte & Touche LLP
1700 Market Street
Philadelphia, PA 19103-3984
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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 statements of financial position of The Pennsylvania State University and subsidiaries (the "University") as of June 30, 2010 and 2009, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the University as of June 30, 2010 and 2009, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

October 18, 2010

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
ASSETS
JUNE 30, 2010 AND 2009
(in thousands)

	June 30, 2010	June 30, 2009
Current assets:		
Cash and cash equivalents	$ 1,203,486	$ 1,094,807
Short-term investments	202,487	132,106
Deposits held by bond trustees	191,340	125,864
Deposits held for others	25,972	25,272
Accounts receivable, net of allowances of $25,571 and $25,320	395,039	407,625
Contributions receivable, net	55,752	54,101
Loans to students, net of allowances of $396 and $504	7,076	8,444
Inventories	31,872	31,572
Prepaid expenses and other assets	70,845	59,436
Investments held under securities lending program	249,959	253,696
Total current assets	2,433,828	2,192,923
Noncurrent assets:		
Deposits held by bond trustees	6,676	6,676
Contributions receivable, net	158,408	122,958
Loans to students, net of allowances of $2,647 and $2,855	49,002	48,075
Deferred bond costs, net	7,260	6,813
Total investment in plant, net	3,151,655	2,970,322
Beneficial interest in perpetual trusts	11,400	11,025
Investments	2,909,271	2,358,585
Total noncurrent assets	6,293,672	5,524,454
Total assets	$ 8,727,500	$ 7,717,377

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
LIABILITIES AND NET ASSETS
JUNE 30, 2010 AND 2009
(in thousands)

	June 30, 2010	June 30, 2009
Current liabilities:		
Accounts payable and other accrued expenses	$ 454,482	$ 390,675
Deferred revenue	222,654	217,243
Long-term debt	52,339	51,884
Present value of annuities payable	4,873	5,038
Accrued postretirement benefits	32,257	31,752
Liability under securities lending program	249,959	253,696
Total current liabilities	1,016,564	950,288
Noncurrent liabilities:		
Deposits held in custody for others	52,783	46,018
Deferred revenue	14,521	17,039
Long-term debt	1,184,072	1,080,555
Present value of annuities payable	31,550	31,928
Accrued postretirement benefits	1,258,530	1,012,433
Refundable United States Government student loans	43,957	44,169
Other liabilities	143,870	131,376
Total noncurrent liabilities	2,729,283	2,363,518
Total liabilities	3,745,847	3,313,806
Net assets:		
Unrestricted -		
Undesignated	1,545	1,386
Designated for specific purposes	1,774,384	1,424,815
Net investment in plant	1,832,776	1,759,274
Total unrestricted	3,608,705	3,185,475
Temporarily restricted	337,570	244,116
Permanently restricted	1,034,721	973,980
Total net assets of The Pennsylvania State University	4,980,996	4,403,571
Noncontrolling interest	657	-
Total net assets	4,981,653	4,403,571
Total liabilities and net assets	$ 8,727,500	$ 7,717,377

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2010
(In thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating revenues and other support:				
Tuition and fees, net of discounts of $109,255	$ 1,353,614	$ -	$ -	$ 1,353,614
Commonwealth of Pennsylvania -				
Appropriations	350,836	-	-	350,836
Special contracts	79,225	-	-	79,225
Department of General Services projects	91,824	-	-	91,824
United States Government grants and contracts	445,630	-	-	445,630
Private grants and contracts	173,032	-	-	173,032
Gifts and pledges	65,027	59,357	-	124,384
Endowment spending	63,401	-	-	63,401
Other investment income	53,069	545	-	53,614
Sales and services of educational activities	54,237	-	-	54,237
Recovery of indirect costs	142,092	-	-	142,092
Auxiliary enterprises	358,785	-	-	358,785
Medical Center revenue	1,027,218	-	-	1,027,218
Other sources	13,142	-	-	13,142
Net assets released from restrictions	26,705	(26,705)	-	-
Total operating revenues and other support	4,297,837	33,197	-	4,331,034
Operating expenses:				
Educational and general -				
Instruction	1,076,891	-	-	1,076,891
Research	742,190	-	-	742,190
Public service	96,355	-	-	96,355
Academic support	344,587	-	-	344,587
Student services	156,034	-	-	156,034
Institutional support	274,327	-	-	274,327
Total educational and general	2,690,384	-	-	2,690,384
Auxiliary enterprises	305,646	-	-	305,646
Medical Center expense	1,009,860	-	-	1,009,860
Total operating expenses	4,005,890	-	-	4,005,890
Increase in net assets from operating activities	291,947	33,197	-	325,144
Non-operating activities:				
Gifts and pledges	-	-	60,483	60,483
Current year investment returns	166,277	59,079	4,894	230,250
Endowment appreciation utilized	(30,586)	-	-	(30,586)
Changes in funds held by others in perpetuity	-	549	351	900
Write-offs and disposals of assets	(4,408)	-	-	(4,408)
Actuarial adjustment on annuities payable	-	629	(4,987)	(4,358)
Increase in net assets from non-operating activities	131,283	60,257	60,741	252,281
Increase in net assets	423,230	93,454	60,741	577,425
Net assets at the beginning of the year	3,185,475	244,116	973,980	4,403,571
Net assets at the end of the year	$ 3,608,705	$ 337,570	$ 1,034,721	$ 4,980,996

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2009
(in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating revenues and other support:				
Tuition and fees, net of discounts of $105,118	$ 1,252,759	$ -	$ -	$ 1,252,759
Commonwealth of Pennsylvania -				
Appropriations	318,072	-	-	318,072
Special contracts	112,576	-	-	112,576
Department of General Services projects	29,855	-	-	29,855
United States Government grants and contracts	416,611	-	-	416,611
Private grants and contracts	168,323	-	-	168,323
Gifts and pledges	64,453	39,071	-	103,524
Endowment spending	65,146	-	-	65,146
Other investment income	61,200	11,267	-	72,467
Sales and services of educational activities	51,533	-	-	51,533
Recovery of indirect costs	128,083	-	-	128,083
Auxiliary enterprises	357,056	-	-	357,056
Medical Center revenue	943,583	-	-	943,583
Other sources	22,367	-	-	22,367
Net assets released from restrictions	34,964	(34,964)	-	-
Total operating revenues and other support	4,026,581	15,374	-	4,041,955
Operating expenses:				
Educational and general -				
Instruction	979,561	-	-	979,561
Research	704,017	-	-	704,017
Public service	83,188	-	-	83,188
Academic support	321,602	-	-	321,602
Student services	151,672	-	-	151,672
Institutional support	260,391	-	-	260,391
Total educational and general	2,500,431	-	-	2,500,431
Auxiliary enterprises	330,524	-	-	330,524
Medical Center expense	932,324	-	-	932,324
Total operating expenses	3,763,279	-	-	3,763,279
Increase in net assets from operating activities	263,302	15,374	-	278,676
Non-operating activities:				
Gifts and pledges	-	-	75,614	75,614
Current year investment returns/(losses)	(212,252)	(285,144)	5,931	(491,465)
Endowment appreciation utilized	(40,637)	-	-	(40,637)
Changes in funds held by others in perpetuity	-	418	(2,637)	(2,219)
Write-offs and disposals of assets	(5,389)	-	-	(5,389)
Actuarial adjustment on annuities payable	-	(626)	163	(463)
Increase (decrease) in net assets from non-operating activities	(258,278)	(285,352)	79,071	(464,559)
Increase (decrease) in net assets	5,024	(269,978)	79,071	(185,883)
Net assets at the beginning of the year	3,180,451	514,094	894,909	4,589,454
Net assets at the end of the year	$ 3,185,475	$ 244,116	$ 973,980	$ 4,403,571

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009
(in thousands)

	June 30, 2010	June 30, 2009
Cash flows from operating activities:		
Increase (decrease) in net assets	$ 577,425	$ (185,883)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Actuarial adjustment on annuities payable	4,358	463
Contributions restricted for long-term investment	(85,019)	(75,722)
Interest and dividends restricted for long-term investment	(23,467)	(13,166)
Net realized and unrealized (gains) losses on long-term investments	(235,936)	455,201
Depreciation and amortization expense	216,034	202,216
Write-offs and disposals of assets	7,020	5,653
Contributions of land, buildings and equipment	(2,343)	(1,023)
Buildings and equipment provided by Pennsylvania Department of General Services	(152)	(633)
Contribution to government student loan funds	234	454
Provision for bad debts	27,297	22,899
Increase in deposits held for others	(700)	(436)
Increase in receivables	(53,222)	(76,426)
Increase in inventories	(301)	(1,656)
Increase in prepaid expenses and other assets	(19,266)	(15,359)
Increase in accounts payable and other accrued expenses	12,735	30,493
Increase in deferred revenue	2,893	8,207
Increase in accrued postretirement benefits	246,603	119,848
Net cash provided by operating activities	674,193	475,130
Cash flows from investing activities:		
Purchase of land, buildings and equipment	(354,052)	(415,594)
Increase in deposits held by bond trustees	(65,476)	(125,770)
Advances on student loans	(7,909)	(8,505)
Collections on student loans	7,426	7,175
Decrease in investments held under securities lending program	3,737	12,029
Decrease in liability under securities lending program	(3,737)	(12,029)
Purchase of investments	(27,207,103)	(4,642,005)
Proceeds from sale of investments	26,864,199	5,026,450
Net cash used in investing activities	(762,915)	(158,249)
Cash flows from financing activities:		
Contributions restricted for long-term investment	85,019	75,722
Interest and dividends restricted for long-term investment	23,467	13,166
Payments of annuity obligations	(4,892)	(5,100)
Proceeds from issuance of bonds	145,005	225,003
Principal payments on notes, bonds and capital leases	(51,804)	(127,826)
Proceeds related to government student loan funds, net of collection costs	606	505
Net cash provided by financing activities	197,401	181,470
Net increase in cash and cash equivalents	108,679	498,351
Cash and cash equivalents at the beginning of the year	1,094,807	596,456
Cash and cash equivalents at the end of the year	$ 1,203,486	$ 1,094,807

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 combined financial statements of The Milton S. Hershey Medical Center ("TMSHMC" or "Medical Center"), a not-for-profit corporation and Penn State Hershey Health System, Inc. ("Health System") and The Corporation for Penn State and its subsidiaries ("the Corporation"). See Note 11 for additional information about TMSHMC and the Health System. 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 assets and revenues consist primarily of the assets and revenues of The Pennsylvania College of Technology ("Penn College"), a wholly-owned subsidiary of the Corporation. All material transactions between the University, TMSHMC and the Corporation have been eliminated.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by the University, as summarized below, are in accordance with the recommendations for accounting and reporting included in the Audit and Accounting Guide for Not-for-Profit Organizations issued by the American Institute of Certified Public Accountants.

Basis of Accounting

The University's consolidated financial statements include statements of financial position, statements of activities and statements of cash flows. Net assets and the changes in net assets are classified as permanently restricted, temporarily restricted or unrestricted in accordance with Accounting Standards Codification ("ASC") No. 980-20 (Statement of Financial Accounting Standards ("SFAS") No. 117 *Financial Statements of Not-for-Profit Organizations).*

Permanently restricted net assets consist primarily of the historical amounts of endowed gifts. Additionally, contributions receivable and remainder interests, which are required by donors to be permanently retained, are included at their estimated present values.

Temporarily restricted net assets consist primarily of contributions receivable and accumulated endowment gains which can be expended, but for which restrictions have not yet been met. Such restrictions include time restrictions imposed by donors or implied by the nature of the gift or by interpretations of law.

Unrestricted net assets are all the remaining net assets of the University.

As permitted, donor-restricted gifts that are received and either spent or deemed spent within the same year are reported as unrestricted revenue. Gifts of long-lived assets are reported as unrestricted revenue. Gifts specified for the acquisition or construction of long-lived assets are reported as unrestricted net assets when the assets are placed in service.

The financial statements of the University have been prepared on the accrual basis of accounting.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 in the fiscal year in which the substantial portion of the educational term occurs. Revenues for auxiliary enterprises are recognized as the related goods and services are delivered and rendered. Grant revenues are recognized as the eligible grant activities are conducted. Payments received in advance for tuition, goods and services are deferred.

Unconditional contributions receivable are recognized when received and consist of written or oral promises to contribute to the University in the future. Contributions receivable are recorded with the revenue assigned to the appropriate category of restriction after discounting to the present value of the future cash flows.

TMSHMC has agreements with third-party payors that provide for payments to TMSHMC at amounts different from its 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. 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.

TMSHMC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates.

Fair Value of Financial Instruments

The University has provided fair value estimates for certain financial instruments in the notes to the financial statements. Fair value information presented in the financial statements is based on information available at June 30, 2010 and 2009. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable are reasonable estimates of their fair value. The carrying values of the amounts 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, 2010 and 2009 have been made at the rates available to students for similar loans at such times. The fair value of investments is disclosed in Note 3. The fair value of the University's bonds payable is disclosed in Note 7. See Note 5 for 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:

	2010	2009
Interest paid	$ 43,970,000	$ 41,495,000
Non-cash acquisitions of land, buildings and equipment	12,956,000	7,150,000

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 three months but less than 12 months.

Accounts Receivable

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

	2010	2009
Grants and contracts, net of allowance of $860,000 and $790,000	$ 134,998,000	$ 181,516,000
Patient accounts receivable, net of allowance of $17,684,000 and $17,859,000	129,871,000	118,379,000
Student receivables, net of allowance of $4,018,000 and $3,947,000	41,965,000	37,008,000
Investment and interest receivable	34,891,000	46,815,000
Other, net of allowance of $3,009,000 and $2,724,000	53,314,000	23,907,000
Total accounts receivable, net	$ 395,039,000	$ 407,625,000

Inventories

Inventories are stated at cost, generally on the first-in, first-out basis, which is lower than market.

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. The University records derivative securities at market value with changes in market value reflected in the consolidated statements of activities.

The estimated fair value amounts for marketable debt and equity securities held by the University have been reviewed by the University and 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, 2010 and 2009. 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.

Beneficial Interest in Perpetual Trusts

The University received endowment income from investments of $11,400,000 and $11,025,000 held by outside trustees at June 30, 2010 and 2009, respectively. The fair value of such investments has been recorded as permanently restricted net assets and related beneficial interest in perpetual trusts in the consolidated financial statements.

Investment in Plant

Fixed assets, including collections, are stated at cost or fair market value at date of gift. Depreciation is computed over the estimated economic lives of the assets using the straight-line method. Total investment in plant as of June 30 is comprised of the following:

	2010	2009
Land	$ 107,382,000	$ 103,108,000
Buildings	4,093,137,000	3,795,427,000
Improvements other than buildings	485,613,000	474,560,000
Equipment	938,440,000	891,909,000
Total plant	5,624,572,000	5,265,004,000
Less accumulated depreciation	(2,472,917,000)	(2,294,682,000)
Total investment in plant, net	$ 3,151,655,000	$ 2,970,322,000

Asset Retirement Obligation

Effective June 30, 2006, the University adopted ASC No. 410-20-55 (Financial Accounting Standards Board ("FASB") Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* ("FIN 47")). ASC 410-20-55 provides an interpretation of ASC 410-20 (Statement of Financial Accounting Standard ("SFAS") No. 143, *Accounting for Retirement Obligations)*, by clarifying that conditional asset retirement obligations meet the definition of a liability even though uncertainty may exist about the timing or method of settlement. Under the provisions of ASC 410-20-55, the University is obligated to record a liability for conditional asset retirement obligations. The University performed an analysis of such obligations and determined that asbestos abatement costs represented the University's primary source of such liabilities. The University reviewed all facilities and determined the timing, method and cost of asbestos abatement using a variety of assumptions and estimates. The accompanying asset retirement obligation was discounted using a rate of 5.25%.

Balance as of June 30, 2008	$ 46,085,000
Accretion expense	2,324,000
Liabilities settled	(1,358,000)
Balance as of June 30, 2009	$ 47,051,000
Accretion expense	2,388,000
Liabilities settled	(1,057,000)
Balance as of June 30, 2010	$ 48,382,000

In addition, the asset retirement obligation of the University also includes obligations related to the Breazeale Nuclear Reactor of $9,081,000 and $8,596,000 at June 30, 2010 and 2009, respectively. Conditional asset retirement obligations of $57,463,000 and $55,647,000 are included in other noncurrent liabilities in the consolidated statement of financial position at June 30, 2010 and 2009, respectively.

Income Taxes

In fiscal year 2008, the University adopted ASC No. 740-10 (FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of ASC No. 740-10 (FASB Statement No. 109"* ("FIN 48")). ASC 740-10 prescribes the minimum recognition threshold a tax position must meet in connection with accounting for uncertainties in income tax positions taken or expected to be taken by an entity, before being measured and recognized in the financial statements. The adoption of ASC 740-10 did not have a material impact on the University's financial statements. The University files U.S. federal income tax returns. No returns are currently under examination. The statute of limitations on the University's U.S. federal information returns generally remain open for three years following the year they are filed.

Accounting Pronouncements

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 168 – "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162". This standard establishes the FASB Accounting Standards Codification ("ASC") as the single source of authoritative U.S. Generally Accepted Accounting Principles ("GAAP"), superseding all previously issued authoritative guidance. References to pre-Codification GAAP in the consolidated financial statements have been replaced with descriptive titles.

On July 1, 2008, the University adopted FASB's ASC guidance on fair value measurements for all financial assets and liabilities. This guidance defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. It emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Fair value measurement should be determined based on the assumptions that market participants would use in pricing an asset or liability including a consideration of nonperformance risk. On July 1, 2009, the University adopted the above mentioned fair value guidance for certain non-financial assets and liabilities. The adoption of this guidance did not have a material impact on the consolidated financial statements of the University.

In April 2009, the FASB issued new ASC guidance for not-for-profit entities regarding mergers and acquisitions. This guidance defines a combination of one or more other not-for-profit entities, business or nonprofit activities as either a merger or acquisition. It also establishes principles and requirements in determining whether a not-for-profit entity combination is a merger or acquisition, applies the carryover method in accounting for mergers, applies the acquisition method in accounting for acquisitions, including which of the combining entities is the acquirer, and requires enhanced disclosures about the merger or acquisition. In addition, it amends existing FASB ASC Guidance on goodwill and other intangible assets and noncontrolling interests in consolidated financial statements to make previous guidance that was only applicable to for-profit entities applicable to not-for-profit entities.

In January 2010, the FASB issued ASC guidance to clarify the scope of noncontrolling interests in consolidated financial statements related to decrease in ownership provisions. This guidance is effective for the University beginning July 1, 2010 as it relates to acquisitions and is effective for the University as it relates to mergers. The University is still assessing the impact of this guidance on the consolidated financial statements as it relates to acquisitions. The guidance as related to mergers did not have any impact during 2010.

In June 2009, the FASB issued ASC guidance on accounting for transfers of financial assets. This guidance clarifies that the objective is to determine whether a transferor and all of the entities included in the transferor's financial statements being presented have surrendered control over transferred financial assets. That determination must consider the transferor's continuing involvements in the transferred financial asset, including all arrangements or agreements made contemporaneously with, or in contemplation of, the transfer, even if they were not entered into at the time of the transfer. This guidance is effective for the year beginning July 1, 2010. The University is still assessing the impact of this guidance on the consolidated financial statements.

In September 2009, the FASB issued ASU No. 2009-12, Fair Value Measurements and Disclosures Topic 820: Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent). ASU 2009-12 amends ASC 820 for Fair Value Measurements and Disclosures to: (1) permit a reporting entity, in certain situations as a practical expedient, to measure the fair value of an alternative investment on the basis of the net asset value per share of the investment, and (2) require additional disclosures for such investments. The changes related to this update are effective periods ending after December 15, 2009. The University adopted this guidance for the year ended June 30, 2010. See Note 5 for disclosure.

In January 2010, the FASB issued ASC guidance that amends current disclosure requirements under the existing fair value accounting standard. It requires entities to disclose separately the amounts of significant transfers into and out of Level 1 and Level 2 fair value measurements along with the reasons for those transfers. In addition, it also requires entities to present separately information about purchases, sales, issuances, and settlements on a gross basis rather than as one net number in the reconciliation for fair value measurements using significant unobservable inputs (Level 3). This guidance is effective for the University beginning on July 1, 2010 except for Level 3 fair value measurement disclosure that is effective July 1, 2011.

In July 2010, the Emerging Issues Task Force ("EITF") reached a consensus-for-exposure on ASU 2010-24, which requires a Healthcare Organization ("HCO") to present a liability related to medical malpractice claims (and other contingent claims) gross; such a liability would not be offset against related insurance recoveries unless the criteria in ASC 210-20 for offsetting were met. Also, the industry specific guidance for the accrual of legal fees associated with resolving contingent claims would be eliminated and HCO's should follow the guidance for such fees in ASC 450-20-S99-2. This guidance is effective for annual reporting periods beginning after December 15, 2010. The University is currently assessing the impact of adopting this guidance on its consolidated financial statements.

In July 2010, the EITF reached a consensus-for-exposure on ASU 2010-23, which requires a HCO to disclose its policy for providing charity care and the amount of charity care provided. In addition, the ASU would require that the amount of charity care be based on the direct and indirect costs of providing charity care, eliminating the other measurement attributes available under ASC 954-605-50-3, and also require disclosure of cost reimbursements associated with providing charity care. This guidance is effective for annual reporting periods beginning after December 15, 2010, and must be applied retrospectively. The University is currently assessing the impact of adopting this guidance on its consolidated financial statements.

3. INVESTMENTS

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

	2010	2009
Money markets	$ 157,193,000	$ 228,451,000
Fixed income:		
U.S. government/agency	892,175,000	447,040,000
U.S. corporate	493,493,000	394,703,000
Foreign	171,535,000	108,004,000
Other	182,902,000	285,384,000
Equities	694,491,000	588,043,000
Private capital	519,969,000	439,066,000
Investments held under securities lending program	249,959,000	253,696,000
Total	$3,361,717,000	$2,744,387,000

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, and hedge fund limited partnerships.

The following schedules summarize the investment return and its classification in the consolidated statement of activities for the years ended June 30, 2010 and June 30, 2009:

2010	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Dividends and interest	$ 77,661,000	$ 545,000	$ 4,894,000	$ 83,100,000
Net realized gains	49,755,000	2,271,000	-	52,026,000
Net unrealized gains	124,745,000	56,808,000	-	181,553,000
Total returns	$ 252,161,000	$ 59,624,000	$ 4,894,000	$ 316,679,000

2009	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Dividends and interest	$ 79,769,000	$ 11,267,000	$ 5,931,000	$ 96,967,000
Net realized losses	(30,140,000)	(83,473,000)	-	(113,613,000)
Net unrealized losses	(176,172,000)	(201,671,000)	-	(377,843,000)
Total returns	$ (126,543,000)	$ (273,877,000)	$ 5,931,000	$(394,489,000)

In the management of investments, the University authorizes certain of its 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. Gains and losses from derivative instruments are reported in the consolidated statements of activities. Futures contracts, which are fully cash collateralized, are marked to market daily and are included in the carrying value of the University's investments. The fair value of all derivative instruments is included in the fair value of the University's investments. Futures contracts have minimal credit risk because the counterparties are the exchanges themselves. Fully cash collateralized derivative securities comprised approximately 1.6% and 1.6% of total investments at June 30, 2010 and 2009.

Through an agreement with its primary investment custodian, the University participates in lending securities to brokers. Collateral is generally limited to cash, government securities, and irrevocable letters of credit. Both the investment custodian and the security borrowers have the right to terminate a specific loan of securities at any time. The University receives lending fees and continues to earn interest and dividends on the loaned securities. At June 30, 2010 and 2009, the University held $249,959,000 and $253,696,000, respectively, of short-term highly liquid investments as collateral deposits for the securities lending program. The collateral is included as an asset and the obligation to return such collateral is presented as a liability in the consolidated statements of financial position. The securities on loan had an estimated fair value of $244,415,000 and $249,278,000 at June 30, 2010 and 2009, respectively.

4. ENDOWMENT NET ASSETS

The University's endowment includes both donor-restricted endowment funds and funds designated to function as endowments. As required by generally accepted accounting principles ("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 University has adopted ASC 980-20 (FSP 117-1) and the enhanced disclosures related to the net asset classification and changes in endowment net assets required by ASC 980-20 have been incorporated in the following tables.

The Commonwealth of Pennsylvania has not adopted UPMIFA but rather is subject to 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 permanently restricted net assets 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. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by PA Act 141. Funds functioning as endowments are classified as unrestricted net assets due to the lack of external donor restrictions. Gains and losses attributable to permanent endowments are recorded as temporarily restricted net assets and gains and losses attributable to funds functioning as endowments are recorded as unrestricted net assets.

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. The aggregate amount of deficiencies at June 30, 2010 and 2009 was $31,662,000 and $59,653,000, respectively, reported in unrestricted net assets on the consolidated statement of activities. Subsequent investment gains will be used to restore the balance up to the fair market value of the original gift. Subsequent gains above that amount will be recorded as temporarily restricted net assets.

Endowment net asset composition by type of fund as of June 30, 2010 and 2009:

2010	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ (31,662,000)	$ 157,325,000	$ 863,312,000	$ 988,975,000
Funds functioning as endowments	361,341,000	-	-	361,341,000
Total net assets	$ 329,679,000	$ 157,325,000	$ 863,312,000	$ 1,350,316,000

2009	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ (59,653,000)	$ 101,838,000	$ 807,047,000	$ 849,232,000
Funds functioning as endowments	324,308,000	-	-	324,308,000
Total net assets	$ 264,655,000	$ 101,838,000	$ 807,047,000	$ 1,173,540,000

Changes in endowment net assets for the years ended June 30, 2010 and 2009:

2010	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of the year	$ 264,655,000	$101,838,000	$ 807,047,000	$1,173,540,000
Endowment return:				
Endowment earnings	32,815,000	-	4,875,000	37,690,000
Net realized gains	30,842,000	782,000	-	31,624,000
Net unrealized gains	29,875,000	82,622,000	-	112,497,000
Reclassification of funds with deficiencies	27,991,000	(27,991,000)	-	-
Total endowment return	121,523,000	55,413,000	4,875,000	181,811,000
Contributions	-	74,000	51,390,000	51,464,000
Endowment spending	(63,401,000)	-	-	(63,401,000)
Transfers to create funds functioning as endowments	6,902,000	-	-	6,902,000
Endowment net assets, end of the year	$ 329,679,000	$157,325,000	$ 863,312,000	$1,350,316,000

2009	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of the year	$ 409,290,000	$359,229,000	$ 754,469,000	$1,522,988,000
Endowment return:				
Endowment earnings	23,521,000	-	2,878,000	26,399,000
Net realized gains (losses)	34,828,000	(75,032,000)	-	(40,204,000)
Net unrealized losses	(86,948,000)	(242,526,000)	-	(329,474,000)
Reclassification of funds with deficiencies	(59,653,000)	59,653,000	-	-
Total endowment return	(88,252,000)	(257,905,000)	2,878,000	(343,279,000)
Contributions	-	514,000	49,700,000	50,214,000
Endowment spending	(65,146,000)	-	-	(65,146,000)
Transfers to create funds functioning as endowments	8,763,000	-	-	8,763,000
Endowment net assets, end of the year	$ 264,655,000	$101,838,000	$ 807,047,000	$1,173,540,000

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 2010 and 4.8% for 2009) of its pooled endowment fund's average fair market value over the prior five years through December 31 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.

5. FAIR VALUE MEASUREMENTS

The University adopted ASC No. 820-10 (SFAS No. 157, *Fair Value Measurements*) on July 1, 2008. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about 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;

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, 2010 about the University's financial assets and liabilities that are measured at fair value on a recurring basis:

	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	$ 158,000	$ 76,764,000	$ -	$ 76,922,000
Fixed income				
U.S. government/agency	113,994,000	15,968,000	-	129,962,000
U.S. corporate	11,640,000	85,060,000	-	96,700,000
Foreign	2,737,000	5,523,000	-	8,260,000
Other	-	6,804,000	-	6,804,000
Equities	479,967,000	156,596,000	-	636,563,000
Private capital	-	102,882,000	413,870,000	516,752,000
Total	$ 608,496,000	$ 449,597,000	$ 413,870,000	$1,471,963,000
Operating investments:				
Money markets	$ 37,701,000	$ 42,570,000	$ -	$ 80,271,000
Fixed income				
U.S. government/agency	334,924,000	427,187,000	102,000	762,213,000
U.S. corporate	8,607,000	388,186,000	-	396,793,000
Foreign	3,116,000	160,159,000	-	163,275,000
Other	-	174,193,000	1,905,000	176,098,000
Equities	54,468,000	17,000	3,443,000	57,928,000
Private capital	-	-	3,217,000	3,217,000
Total	$ 438,816,000	$1,192,312,000	$ 8,667,000	$1,639,795,000
Investments held under securities lending program	$ -	$ -	$ 249,959,000	$ 249,959,000
Deposits held by bond trustees:				
Money markets	$ 121,342,000	$ -	$ -	$ 121,342,000
Fixed income				
U.S. government/agency	69,998,000	6,676,000	-	76,674,000
Total	$ 191,340,000	$ 6,676,000	$ -	$ 198,016,000
Beneficial interest in perpetual trusts	$ -	$ -	$ 11,400,000	$ 11,400,000
Liabilities:				
Present value of annuities payable	$ -	$ -	$ 36,423,000	$ 36,423,000
Liability under securities lending program	$ -	$ -	$ 249,959,000	$249,959,000

The following table presents information as of June 30, 2009 about the University's financial assets and liabilities that are measured at fair value on a recurring basis:

	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	$ 4,067,000	$ 92,575,000	$ 2,110,000	$ 98,752,000
Fixed income				
U.S. government/agency	69,802,000	34,387,000	3,417,000	107,606,000
U.S. corporate	12,643,000	20,384,000	7,253,000	40,280,000
Foreign	-	-	1,883,000	1,883,000
Other	1,784,000	2,877,000	21,339,000	26,000,000
Equities	335,823,000	234,000	128,008,000	464,065,000
Private capital	-	-	433,390,000	433,390,000
Total	$ 424,119,000	$ 150,457,000	$ 597,400,000	$1,171,976,000
Operating investments:				
Money markets	$ 38,159,000	$ 83,989,000	$ 7,551,000	$ 129,699,000
Fixed income				
U.S. government/agency	115,791,000	192,989,000	30,654,000	339,434,000
U.S. corporate	47,989,000	213,354,000	93,080,000	354,423,000
Foreign	3,540,000	92,585,000	9,996,000	106,121,000
Other	12,630,000	42,208,000	204,546,000	259,384,000
Equities	117,799,000	1,756,000	4,423,000	123,978,000
Private capital	-	-	5,676,000	5,676,000
Total	$ 335,908,000	$ 626,881,000	$ 355,926,000	$1,318,715,000
Investments held under securities lending program	$ -	$ -	$ 253,696,000	$ 253,696,000
Deposits held by bond trustees:				
Fixed income				
U.S. government/agency	$ 125,864,000	$ 6,676,000	$ -	$ 132,540,000
Total	$ 125,864,000	$ 6,676,000	$ -	$ 132,540,000
Beneficial interest in perpetual trusts	$ -	$ -	$ 11,025,000	$ 11,025,000
Liabilities:				
Present value of annuities payable	$ -	$ -	$ 36,966,000	$ 36,966,000
Liability under securities lending program	$ -	$ -	$ 253,696,000	$253,696,000

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, 2010 and 2009, fair value of endowment funds and funds functioning as endowments within the LTIP totaled $1,350,316,000 and $1,171,976,000, respectively. At June 30, 2010 and 2009, fair value of operating funds included in the LTIP totaled $121,647,000 and -0-, respectively.

The following tables present information related to changes in Level 3 for each category of assets and liabilities for year ended June 30, 2010:

	Long-term Investment Pool	Operating Investments	Investments Held Under Securities Lending	Beneficial Interest in Perpetual Trusts
Assets:				
Beginning balance	$ 597,400,000	$ 355,926,000	$ 253,696,000	$ 11,025,000
Total realized and unrealized gains/(losses)	93,438,000	27,154,000	-	375,000
Purchases and settlements	(38,734,000)	(218,399,000)	(3,737,000)	-
Transfers in/(out) of Level 3	(238,234,000)	(156,014,000)	-	-
Ending balance	$ 413,870,000	$ 8,667,000	$ 249,959,000	$ 11,400,000

	Present Value of Annuities Payable	Liability Under Securities Lending
Liabilities:		
Beginning balance	$ 36,966,000	$ 253,696,000
Actuarial adjustment of liability	(294,000)	-
Gifts and severances	(249,000)	-
Purchases and settlements	-	(3,737,000)
Ending balance	$ 36,423,000	$ 249,959,000

The following tables present information related to changes in Level 3 for each category of assets and liabilities for year ended June 30, 2009:

	Long-term Investment Pool	Operating Investments	Investments Held Under Securities Lending	Beneficial Interest in Perpetual Trusts
Assets:				
Beginning balance	$ 794,454,000	$ 814,538,000	$ 265,725,000	$ 13,673,000
Total realized and unrealized gains/(losses)	(210,500,000)	(28,446,000)	-	(2,648,000)
Purchases and settlements	1,952,000	(432,735,000)	(12,029,000)	-
Transfers in/(out) of Level 3	11,494,000	2,569,000	-	-
Ending balance	$ 597,400,000	$ 355,926,000	$ 253,696,000	$ 11,025,000

	Present Value of Annuities Payable	Liability Under Securities Lending
Liabilities:		
Beginning balance	$ 41,538,000	$ 265,725,000
Actuarial adjustment of liability	(2,355,000)	-
Gifts and severances	(2,217,000)	-
Purchases and settlements	-	(12,029,000)
Ending balance	$ 36,966,000	$ 253,696,000

In September 2009, the FASB issued new ASC guidance on fair value measurements and disclosures related to investments in certain entities that calculate net asset value per share. This guidance requires enhanced disclosures about the risks of such investments.

The following table presents the fair value and redemption frequency for those investments whose fair value is not readily determinable and is estimated using the net asset value per share or its equivalent as of June 30, 2010:

	Fair Value	Unfunded Commitment	Redemption Frequency	Redemption Notice Period
Commingled Funds:				
Non-U.S. Equity	$ 156,596,000		Daily/Monthly	5-15 days
Fixed Income	131,592,000		Daily	5 days
Subtotal	$ 288,188,000			
Marketable Investment Partnerships:				
Absolute Return	$ 22,202,000		Quarterly	60 days
Private Debt	54,607,000		Quarterly/ Semi Annual	60-90 days
Directional Long/Short	51,897,000		Quarterly	30-65 days
Subtotal	$ 128,706,000			
Non-Marketable Investment Partnerships:				
Private Real Estate	$ 56,203,000	$ 30,902,000		
Venture Capital	69,567,000	80,349,000		
Private Equity	185,470,000	79,396,000		
Natural Resources	54,720,000	25,473,000		
Private Debt	25,302,000	2,013,000		
Subtotal	$ 391,262,000	$ 218,133,000		
Total	$ 808,156,000	$ 218,133,000		

Commingled funds include investments that aggregate assets from multiple investors and are managed collectively following a prescribed strategy. Redemptions vary from daily to monthly with required notification of 30 days or less. The non-U.S. equity strategy is invested in developed and developing markets 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. The fixed income strategy is comprised primarily of investment grade fixed income securities, with up to a maximum of 30% in non-investment grade securities. Duration is +/- 20% of Barclays Aggregate Index.

Marketable Investment Partnerships include hedge funds whose underlying positions are traded via public securities markets. Liquidity terms range from quarterly to semi-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 ownership interest in partner's capital. Three major investment strategies are included within this category. Absolute Return is comprised primarily of equity long/short and multi-strategy arbitrage strategies. Private Debt is comprised of credit securities rated below investment grade in addition to non-rated debt. Directional Long/Short is comprised primarily of equity long/short strategies in both U.S. and non-U.S. markets.

Nonmarketable Investment Partnerships include several private capital funds. The fair values of the investments for each fund in this category have been estimated using the net asset value of the ownership interest in partner's capital and can never 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 for which capital calls have not been exercised as of June 30, 2010. Five major investment strategies are included within this category. Private Real Estate primarily includes commercial real estate properties located throughout the U.S. Venture Capital includes non-public startups and enterprises in early stages of growth within the U.S. Private Equity includes buyouts of previously public companies as well as enterprises that are planning to go public in the near future, including three funds focusing on opportunities outside the U.S. Natural Resources largely include companies involved in natural gas in addition to a variety of other natural resources. Private Debt includes private credit securities rated below investment grade as well as non-rated debt.

6. CONTRIBUTIONS RECEIVABLE

Contributions receivable are summarized as follows as of June 30:

	2010	2009
In one year or less	$ 60,895,000	$ 65,905,000
Between one year and five years	97,942,000	79,949,000
More than five years	119,605,000	93,923,000
	278,442,000	239,777,000
Less allowance	(3,656,000)	(9,779,000)
Less discount	(60,626,000)	(52,939,000)
Contributions receivable, net	$ 214,160,000	$ 177,059,000

At June 30, 2010 and 2009, the University has received bequest intentions and certain other conditional promises to give of $39,048,000 and $34,107,000, 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, 2010:

Balance beginning of year	$ 177,059,000
New pledges	61,410,000
Collections on pledges	(22,745,000)
Decrease in allowance	6,123,000
Increase in unamortized discounts	(7,687,000)
Balance at the end of year	$214,160,000

The following table summarizes the change in contributions receivable, net during the year ended June 30, 2009:

Balance beginning of year	$145,699,000
New pledges	57,415,000
Collections on pledges	(26,873,000)
Decrease in allowance	799,000
Decrease in unamortized discounts	19,000
Balance at the end of year	$177,059,000

7. LONG-TERM DEBT

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

The Pennsylvania State University Bonds	2010	2009
Series 2010 – payable in amounts ranging from $3,655,000 to $6,280,000 through March 2030 with additional amounts of $21,805,000 and $44,245,000 due March 2035 and 2040, respectively, with fixed interest rates ranging from 3.375% to 5.00%	$ 135,035,000	$ -
Series 2009A – payable in amounts ranging from $5,540,000 to $9,320,000 through March 2029, with fixed interest rates ranging from 3.00% to 5.00%	131,460,000	138,060,000
Series 2009B – payable in June 2031, with interest at a variable rate (0.40% at June 30, 2010)	74,235,000	74,235,000
Series 2008A – payable in amounts ranging from $1,840,000 to $7,695,000 through August 2029, with a fixed interest rate of 5.00%	77,670,000	77,670,000
Series 2008B – payable in amounts ranging from $855,000 to $1,050,000 through August 2016, with fixed interest rates ranging from 3.00% to 3.75%	6,630,000	7,460,000
Series 2007A – payable in amounts ranging from $490,000 to $700,000 through August 2022 with additional amounts of $11,115,000 and $70,905,000 in August 2028 and 2036, respectively, with fixed interest rates ranging from 3.625% to 4.50%	89,640,000	90,110,000
Series 2007B – payable in amounts ranging from $2,515,000 to $5,955,000 through August 2027, with fixed interest rates ranging from 4.25% to 5.25%	71,395,000	73,810,000
Series 2005 – payable in amounts ranging from $1,835,000 to $2,745,000 through September 2019 with additional amounts of $15,990,000, $20,550,000, and $32,485,000 in September 2024, 2029, and 2034, respectively, with fixed interest rates ranging from 3.00% to 5.00%	91,395,000	93,165,000
Series 2004A – payable in amounts ranging from $1,195,000 to $1,825,000 through September 2019 with additional amounts of $10,625,000, $13,635,000, and $17,515,000 in September 2024, 2029, and 2034, respectively, with fixed interest rates ranging from 3.625% to 5.00%	56,580,000	57,730,000

	2010	2009
Refunding Series 2003 – payable in amounts ranging from $2,140,000 to $2,970,000 through March 2018, with fixed interest rates ranging from 4.00% to 5.25%	20,280,000	22,355,000
Series of 2002 – payable in March 2032, with interest at a variable rate (0.25% at June 30, 2010)	100,000,000	100,000,000
Refunding Series 2002 – payable in amounts ranging from $4,585,000 to $16,540,000 through August 2016, with fixed interest rates ranging from 4.79% to 5.25%	84,130,000	96,945,000
Refunding Series 2001 – payable in March 2011, with a fixed interest rate of 5.25%	9,290,000	18,140,000
Pennsylvania Higher Educational Facilities Authority University Revenue Bonds (issued for The Pennsylvania State University)		
Series 2006 – payable in amounts ranging from $185,000 to $280,000 with an additional amount of $1,610,000 in 2025, with fixed interest rates ranging from 3.75% to 5.125%	4,125,000	4,305,000
Series 2004 – payable in amounts ranging from $220,000 to $325,000 with an additional amount of $1,905,000 in 2024, with fixed interest rates ranging from 3.65% to 5.00%	4,595,000	4,810,000
Series 2002 – payable in amounts ranging from $330,000 to $425,000 with an additional amount of $2,435,000 in 2022, with fixed interest rates ranging from 4.00% to 5.00%	5,050,000	5,365,000
Lycoming County Authority College Revenue Bonds (issued for Penn College)		
Series 2008 – payable in amounts ranging from $1,455,000 to $4,140,000 through October 2037, with fixed interest rates ranging from 3.50% to 5.50%	55,000,000	55,000,000
Series 2005 – payable in amounts ranging from $505,000 to $1,855,000 through January 2025, with fixed interest rates ranging from 3.50% to 5.00%	13,535,000	14,035,000
Series 2002 – payable in amounts ranging from $380,000 to $2,775,000 through May 2032, with fixed interest rates ranging from 4.30% to 5.25%	28,930,000	29,300,000

	2010	2009
Series 2000 – payable in amounts ranging from $30,000 to $5,225,000 through July 2030, with fixed interest rates ranging from 4.80% to 5.50%	39,305,000	39,370,000
Series 1993 – payable in amounts ranging from $450,000 to $619,000 through November 2015, with fixed interest rates ranging from 6.05% to 6.15%	10,500,000	13,940,000
Total bonds payable	1,108,780,000	1,015,805,000
Unamortized bond premiums	44,261,000	36,717,000
Note payable and capital leases		
Note payable	2,000,000	4,000,000
Capital lease obligations	81,370,000	75,917,000
Total notes payable and capital leases	83,370,000	79,917,000
Total long-term debt	$1,236,411,000	$1,132,439,000

The Series 2010 bonds are general obligation bonds issued in May 2010 for the purpose of funding various construction and renovation projects. The Series 2010 Bonds are subject to early redemption provisions, at the option of the University, beginning March 2021. The bonds maturing on March 2035 and 2040 are subject to sinking fund redemption.

The Series 2009A and 2009B bonds are general obligation bonds issued in May 2009 and June 2009, respectively, for the purpose of funding various construction and renovation projects and for the current refunding of the Series A of 2001 Bonds. The University, in conjunction with the issuance of the Series 2009B Bonds, legally defeased the Series A of 2001 Bonds, with an outstanding principal of $75,000,000. As a result of the current refunding transaction, amounts related to the Series A of 2001 Bonds have been removed from the University's June 30, 2009 consolidated statement of financial position. The Series 2009A Bonds are subject to early redemption provisions, at the option of the University, beginning March 2019. The Series 2009B Bonds are currently paying interest on a variable rate basis at a long term rate for the period June 1, 2010 through May 31, 2011. 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 0.40% 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 amount up to a maximum of 12%. 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 Series of 2002 bonds currently pay interest on a variable rate basis in the weekly mode; however, the University has the option to convert to another variable rate (daily, monthly, flexible, semiannual or long mode) or to a fixed rate basis. The bonds currently pay interest at 0.25% with adjustment on a weekly basis to the rate the remarketing agent believes will cause the bonds to have a market value equal to the principal amount up to a maximum of 12%. The bondholders have the right to tender bonds at interest rate reset dates. The University, therefore, entered into standby bond purchase agreement with a bank to provide liquidity in case of tender. The bonds are not subject to sinking fund redemption; however, the University has the option to redeem the bonds prior to their scheduled maturity.

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
2011	$ 40,945,000
2012	33,405,000
2013	35,035,000
2014	36,825,000
2015	38,640,000
Thereafter	923,930,000

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, 2010, the carrying value and estimated fair value of the University's bonds payable, including issuance premiums, are $1,153,041,000 and $1,168,348,000, respectively. At June 30, 2009, the carrying value and estimated fair value of the University's bonds payable, including issuance premiums, were $1,052,522,000 and $1,053,279,000, respectively. Certain bond issues have associated issuance premiums, these issuance premiums total $44,261,000 and $36,717,000 at June 30, 2010 and 2009, 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.

Note payable and capital leases

A $2,000,000 note payable with principal payment due in May 2011 is included within the consolidated statements of financial position at June 30, 2010.

The University has certain 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 net present value of the minimum lease payments. The capitalized cost and accumulated depreciation of the leases at June 30, 2010 and 2009 was $99,187,000 and $21,657,000, and $90,298,000 and $15,735,000, respectively. Future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of June 30, 2010 are as follows:

Year	
2011	$ 11,692,000
2012	11,271,000
2013	10,241,000
2014	8,663,000
2015	7,694,000
Thereafter	157,730,000
Total minimum lease payments	207,291,000
Less imputed interest	(125,921,000)
Capital lease obligation	81,370,000
Current portion	6,557,000
Long-term portion	$ 74,813,000

8. OPERATING LEASES

The University has certain lease agreements in effect which are considered operating leases. During the year ended June 30, 2010, the University recorded expenses of $21,341,000 for leased equipment and $21,368,000 for leased building space. During the year ended June 30, 2009, the University recorded expenses of $20,981,000 for leased equipment and $17,476,000 for leased building space.

Future minimum lease payments under operating leases as of June 30, 2010 are as follows:

Year	
2011	$ 20,417,000
2012	15,154,000
2013	12,209,000
2014	10,710,000
2015	9,952,000
Thereafter	62,125,000
Total minimum lease payments	$130,567,000

9. 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 and The Public School Employees' Retirement System or defined contribution plans administered by the Teachers Insurance and Annuity Association – College Retirement Equity Fund and Fidelity Investments. The University is billed for its share of the estimated actuarial cost of the defined benefit plans ($11,043,000 and $11,386,000 for the years ended June 30, 2010 and 2009, respectively). The University's total cost for retirement benefits, included in expenses, is $110,485,000 and $107,570,000 for the years ended June 30, 2010 and 2009, respectively.

10. POSTRETIREMENT BENEFITS

The University sponsors a retiree medical plan covering eligible retirees and eligible dependents. For the 2010 benefit plan year, this program includes a Preferred Provider Organization ("PPO") plan for retirees and their dependents who are not eligible for Medicare, a Medicare Advantage Private Fee For Service ("PFFS") plan and a Medicare Supplement plan. In addition, the University provides retiree life insurance benefits of $5,000 at no cost to the retiree. A limited number of retirees have $10,000 of life insurance coverage; $5,000 of which is provided by the University and $5,000 is paid by the retiree.

Employees who were hired prior to January 1, 2010 are eligible for medical coverage and life insurance after they retire if:

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

OR

- 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.

The retiree PPO medical plan and the $5,000 life insurance coverage are self-funded programs, and all medical claims, death benefits and other expenses are paid from the unrestricted net assets of the University. The PFFS plan and the Medicare Supplement plan are fully insured. The retirees pay varying amounts for coverage under the medical plan. As of January 1, 2010, the monthly amounts ranged from $32 to $247 depending on age and dependent coverage options selected.

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 Penn State Retirement Savings Account when they are no longer actively employed at Penn State AND have:

- Completed 25 years of continuous full-time service and are age 60 or older

OR

- Completed a minimum of 15 years of continuous full-time service and are age 65 or older

Included in unrestricted net assets at June 30, 2010 and 2009 are the following amounts that have not yet been recognized in net periodic postretirement cost: unrecognized prior service cost (benefit) of ($151,388,000) and ($172,502,000) and unrecognized actuarial loss of $521,822,000 and $367,969,000, 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:

	2010	2009
Benefit obligation at beginning of year	$ 1,044,185,000	$ 924,337,000
Service cost	42,216,000	38,189,000
Interest cost	66,363,000	60,261,000
Actuarial loss	32,068,000	53,026,000
Benefits paid	(35,479,000)	(31,887,000)
Plan amendment	-	259,000
Plan assumptions	141,434,000	-
Benefit obligation at end of year	$ 1,290,787,000	$ 1,044,185,000

Change in plan assets:

	2010	2009
Fair value of plan assets at beginning of year	$ -	$ -
Employer contributions	35,479,000	31,887,000
Benefits paid	(35,479,000)	(31,887,000)
Fair value of plan assets at end of year	$ -	$ -
Funded status	$(1,290,787,000)	$ (1,044,185,000)
Unrecognized prior service cost (benefit)	-	-
Unrecognized net actuarial loss	-	-
Accrued postretirement benefit expense	$(1,290,787,000)	$ (1,044,185,000)

Net periodic postretirement cost includes the following components for the years ended June 30:

	2010	2009
Service cost	$ 42,216,000	$ 38,189,000
Interest cost	66,363,000	60,261,000
Amortization of prior service cost	(21,651,000)	(21,629,000)
Amortization of unrecognized net loss	20,187,000	19,705,000
Net periodic postretirement cost	$ 107,115,000	$ 96,526,000

The assumed healthcare cost trend rate used in measuring the accumulated postretirement benefit obligation was 8.0% and 8.50% for the years ended June 30, 2010 and 2009, respectively, reduced by 0.50% per year to a fixed level of 5.00%. The weighted average postretirement benefit obligation discount rate was 5.50% and 6.25% for the years ended June 30, 2010 and 2009, respectively.

If the healthcare cost trend rate assumptions were increased by 1% in each year, the accumulated postretirement benefit obligation would be increased by $234,829,000 and $178,092,000 as of June 30, 2010 and 2009, 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 $22,402,000 and $20,225,000 as of June 30, 2010 and 2009, respectively. If the healthcare cost trend rate assumptions were decreased by 1% in each year, the accumulated postretirement benefit obligation would be decreased by $186,265,000 and $142,673,000 as of June 30, 2010 and 2009, 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 $17,447,000 and $15,759,000 as of June 30, 2010 and 2009, 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:

2011	$ 45,058,000
2012	48,017,000
2013	49,991,000
2014	52,635,000
2015	55,654,000
2016-20	322,630,000

11. THE MILTON S. HERSHEY MEDICAL CENTER AND PENN STATE HERSHEY HEALTH SYSTEM

The University's wholly-owned subsidiary, TMSHMC, owns the assets of the clinical enterprise of the Hershey Medical Center complex. The University owns the Hershey Medical Center complex, including all buildings and land occupied by the Medical Center and operates the College of Medicine. The clinical facilities of the Hershey Medical Center complex are leased to TMSHMC and TMSHMC makes certain payments to support the College of Medicine.

The Health System is a corporate investor in healthcare joint ventures, which are supportive of the missions of the Medical Center. The Health System was organized in 1995 as a wholly-owned subsidiary of the Corporation for the purpose of organizing components of an integrated health care delivery system. In 2010, the Health System recorded $657,000 of non-controlling interest related to the acquisition of additional ownership interest in a joint venture. This is recorded in the net assets within the consolidated statements of financial position.

12. 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 $724,008,000 of which $430,164,000 has been paid or accrued as of June 30, 2010. 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 $17,352,000 and $13,878,000 as of June 30, 2010 and 2009, 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. Due to the nature of the guarantees, it is not possible to quantify the exposure to the University. As result, no liabilities related to guarantees have been recorded as of June 30, 2010.

Self-Insurance

The University has a coordinated program of commercial and self-insurance for medical malpractice claims at TMSHMC 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 3% and 4% at June 30, 2010 and 2009, respectively, of the medical malpractice claims liability in the amount of $71,419,000 and $67,988,000 is recorded as of June 30, 2010 and 2009, respectively.

On July 1, 2003, TMSHMC became self-insured for all medical malpractice claims asserted on or after July 1, 2003, for all amounts that are below the coverage of the TMSHMC's excess insurance policies and not included in the insurance coverage of the Mcare Fund. Under the self-insurance program, TMSHMC 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 $22,305,000 and $17,764,000 at June 30, 2010 and 2009, respectively. TMSHMC 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 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 $14,067,000 and $13,243,000, discounted at 1.25%, is recorded as of June 30, 2010 and 2009, respectively. The University has established a trust fund, in the amount of $12,168,000 and $11,590,000 at June 30, 2010 and 2009, respectively, as required by PA-DLI, to provide for the payment of claims under this self-insurance program. TMSHMC is self-insured for workers' compensation claims and has purchased an excess policy through a commercial insurer which covers individual claims in excess of $500,000 per incident for workers' compensation claims.

The University and TMSHMC are self-insured for certain health care benefits provided to employees. The University and TMSHMC have purchased excess policies which cover employee health benefit claims in excess of $500,000 and $350,000 per employee per year, respectively. The University and TMSHMC provide for reported claims and claims incurred but not reported.

Litigation and Contingencies

Various legal proceedings have arisen in the 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.

Based on its operation of the Medical Center (see Note 11), the University, like 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.

13. SUBSEQUENT EVENTS

The University has evaluated subsequent events through October 18, 2010, the date when the financial statements were available to be issued. It did not identify any subsequent events to be disclosed.

THE PENNSYLVANIA STATE UNIVERSITY

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VIRTUE LIBERTY AND INDEPENDENCE