



December 23, 2014

Director, Office of Nuclear Material Safety and Safeguards  
U.S. Nuclear Regulatory Commission  
Document Control Desk  
11555 Rockville Pike  
Rockville, Maryland 20852 - 2738

Subj: University – Annual Financial Test submittal and Self-Guarantee –  
Year Ending June 30, 2014

License numbers:	R-2	Breazeale Nuclear Reactor	Docket 050-00005
	SNM-95	Penn State University	Docket 070-00113

Dear Sir or Madam,

Attachment A contains The Pennsylvania State University's Audited Financial Statements for the last fiscal year (July 1, 2013 through June 30, 2014). In addition to the enclosed report, an electronic version may also be found at

<http://controller.psu.edu/sites/default/files/users/controller/docs/FinStmts/2014FinStmts.pdf>

As required in 10 CFR 30.35.(f).(2), the financial test and self-guarantee method of 10 CFR 30 Appendix E will be used. The Pennsylvania State University certifies the following:

- (i) 10 CFR 30 Appendix E Paragraph II.A.(1) – The University currently holds a rating for its most recent bond issuance of **AA** as issued by Standard and Poor's, and a bond rating of **Aa2** as issued by Moody's, and
- (ii) The University is currently a going concern, and it possessed positive net assets in the amount of \$7,683,525,000 at June 30, 2014. The calculation of the University's net assets at June 30, 2014 was derived from the University's independently audited, year-end financial statements and footnotes for the fiscal year ended June 30, 2013. The University is not required to file a Form 10-K with the Securities and Exchange Commission for the latest fiscal year.
- (iii) 10 CFR 30 Appendix E Paragraph II.C.(1) – Audited financial statements are attached. The Independent Accountant's Report on Applying Agreed-Upon Procedures will follow under separate cover the week of January 5, 2015.

A020  
N/MSS01

In addition, Attachment B contains Penn State University's Self-Guarantee Agreement for Financial Assurance for Cost of Decommissioning Activities.

Please contact Jeffrey Leavey at 814-865-3939 or JAL62@psu.edu if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Joseph J. Doncsecz". The signature is fluid and cursive, with a long horizontal stroke at the end.

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

Attachment A – Audited financial statements

Attachment B – Penn State University's self-guarantee agreement

cc: Jeffrey Leavey, Radiation Safety Officer

Mark Trump, Associate Director, Radiation Science and Engineering Center

Jody Murawski, Corporate Controller's Office, University Park

**ATTACHMENT A – Penn State University Audited Financial Statements**

PENNSSTATE

---



---

# **Audited Financial Statements**

---

The Pennsylvania State University  
Fiscal Year Ended June 30, 2014

# THE PENNSYLVANIA STATE UNIVERSITY

## UNIVERSITY OFFICERS

as of November 14, 2014

**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**

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

**NICHOLAS P. JONES**

Executive Vice President  
and Provost

**RODNEY P. KIRSCH**

Senior Vice President for Development  
and Alumni Relations

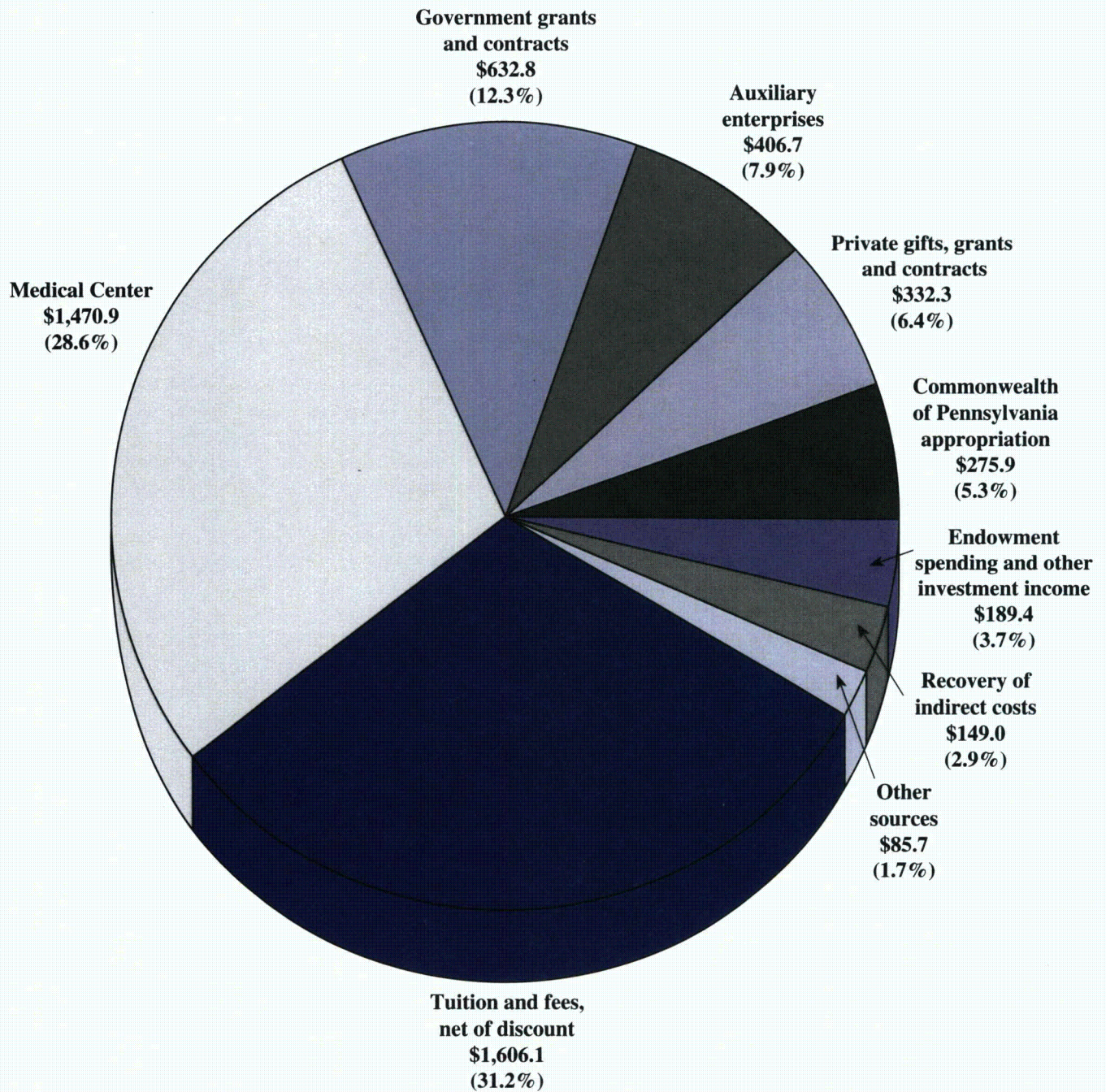
## **CONTENTS**

Operating Revenues by Source	2
Operating Expenses by Function	3
Letter of Transmittal	5
Independent Auditors' Report	6
Consolidated Financial Statements:	
Statements of Financial Position	8
Statements of Activities	10
Statements of Cash Flows	12
Notes to Consolidated Financial Statements	13

# OPERATING REVENUES BY SOURCE (\$5.1 billion)

For the Year Ended June 30, 2014

(\$ in millions)

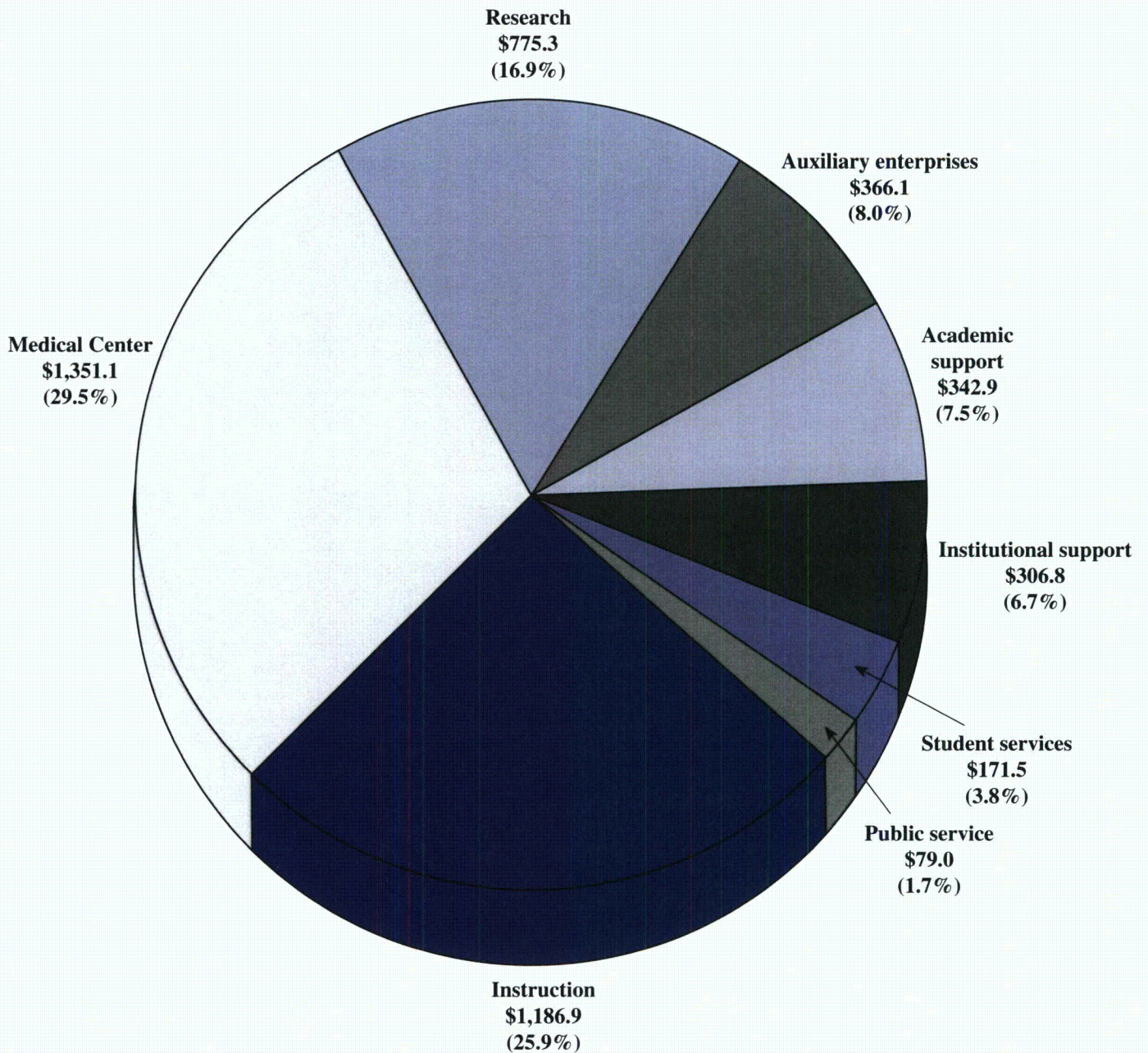




# OPERATING EXPENSES BY FUNCTION (\$4.6 billion)

For the Year Ended June 30, 2014

(\$ in millions)





**This Page is Intentionally Blank.**



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

(814) 865-1355  
(814) 863-0701

The Pennsylvania State University  
408 Old Main  
University Park, PA 16802-1505

October 24, 2014

Dr. Eric J. Barron, President  
The Pennsylvania State University

Dear Dr. Barron:

The audited consolidated financial statements of The Pennsylvania State University and subsidiaries (the "University") for the fiscal years ended June 30, 2014 and 2013 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

## **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, 2014 and 2013, 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.

### **Auditors' 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, 2014 and 2013, 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 24, 2014

**THE PENNSYLVANIA STATE UNIVERSITY**  
**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**  
**ASSETS**  
**JUNE 30, 2014 AND 2013**  
**(in thousands)**

	<u>June 30, 2014</u>	<u>June 30, 2013</u>
<b>Current assets:</b>		
Cash and cash equivalents	\$ 1,028,529	\$ 983,256
Short-term investments	365,851	200,273
Deposits held for others	57,014	44,166
Accounts receivable, net of allowances of \$72,957 and \$66,974	527,213	492,404
Contributions receivable, net	63,573	50,411
Loans to students, net of allowances of \$384 and \$584	8,163	10,683
Inventories	35,484	31,406
Prepaid expenses and other assets	<u>114,963</u>	<u>115,463</u>
<b>Total current assets</b>	<u>2,200,790</u>	<u>1,928,062</u>
<b>Noncurrent assets:</b>		
Deposits held by bond trustees	2,551	2,551
Contributions receivable, net	150,891	127,726
Loans to students, net of allowances of \$2,319 and \$2,497	52,654	48,161
Deferred bond costs, net	5,095	5,181
Total investment in plant, net	3,944,252	3,730,764
Beneficial interest in perpetual trusts	15,498	13,252
Investments	5,319,035	4,816,961
Other assets	<u>19,841</u>	<u>17,958</u>
<b>Total noncurrent assets</b>	<u>9,509,817</u>	<u>8,762,554</u>
 <b>Total assets</b>	 <u><u>\$ 11,710,607</u></u>	 <u><u>\$ 10,690,616</u></u>

See notes to consolidated financial statements.

**THE PENNSYLVANIA STATE UNIVERSITY**  
**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**  
**LIABILITIES AND NET ASSETS**  
**JUNE 30, 2014 AND 2013**  
**(in thousands)**

	<u>June 30, 2014</u>	<u>June 30, 2013</u>
<b>Current liabilities:</b>		
Accounts payable and other accrued expenses	\$ 526,815	\$ 660,096
Deferred revenue	271,684	264,727
Long-term debt	47,177	43,650
Present value of annuities payable	5,597	5,276
Accrued postretirement benefits	<u>53,350</u>	<u>51,390</u>
<b>Total current liabilities</b>	<u>904,623</u>	<u>1,025,139</u>
<b>Noncurrent liabilities:</b>		
Deposits held in custody for others	40,619	50,804
Deferred revenue	1,952	6,969
Long-term debt	934,311	961,758
Present value of annuities payable	45,554	36,979
Accrued postretirement benefits	1,847,056	1,643,651
Refundable United States Government student loans	46,318	45,300
Other liabilities	<u>206,649</u>	<u>210,919</u>
<b>Total noncurrent liabilities</b>	<u>3,122,459</u>	<u>2,956,380</u>
<b>Total liabilities</b>	<u>4,027,082</u>	<u>3,981,519</u>
<b>Net assets:</b>		
Unrestricted -		
Undesignated	1,637	1,635
Designated for specific purposes	3,182,328	2,757,846
Net investment in plant	<u>2,473,238</u>	<u>2,246,228</u>
<b>Total unrestricted - The Pennsylvania State University</b>	<u>5,657,203</u>	<u>5,005,709</u>
Noncontrolling interest	<u>961</u>	<u>831</u>
<b>Total unrestricted</b>	<u>5,658,164</u>	<u>5,006,540</u>
Temporarily restricted	694,240	484,375
Permanently restricted	<u>1,331,121</u>	<u>1,218,182</u>
<b>Total net assets</b>	<u>7,683,525</u>	<u>6,709,097</u>
<b>Total liabilities and net assets</b>	<u>\$ 11,710,607</u>	<u>\$ 10,690,616</u>

See notes to consolidated financial statements.



**THE PENNSYLVANIA STATE UNIVERSITY**  
**CONSOLIDATED STATEMENT OF ACTIVITIES**  
**FOR THE YEAR ENDED JUNE 30, 2014**  
(in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Operating revenues and other support:</b>				
Tuition and fees, net of discounts of \$153,724	\$ 1,606,079	\$ -	\$ -	\$ 1,606,079
Commonwealth of Pennsylvania -				
Appropriations	275,931	-	-	275,931
Special contracts	71,750	-	-	71,750
Department of General Services projects	82,337	-	-	82,337
United States Government grants and contracts	478,699	-	-	478,699
Private grants and contracts	184,722	-	-	184,722
Gifts and pledges	104,947	42,672	-	147,619
Endowment spending	75,383	-	-	75,383
Other investment income	113,349	674	-	114,023
Sales and services of educational activities	66,758	-	-	66,758
Recovery of indirect costs	148,988	-	-	148,988
Auxiliary enterprises	406,685	-	-	406,685
Medical Center revenue	1,470,925	-	-	1,470,925
Other sources	18,925	-	-	18,925
Net assets released from restrictions	25,649	(25,649)	-	-
<b>Total operating revenues and other support</b>	<b>5,131,127</b>	<b>17,697</b>	<b>-</b>	<b>5,148,824</b>
<b>Operating expenses:</b>				
Educational and general -				
Instruction	1,186,941	-	-	1,186,941
Research	775,321	-	-	775,321
Public service	78,960	-	-	78,960
Academic support	342,876	-	-	342,876
Student services	171,484	-	-	171,484
Institutional support	306,833	-	-	306,833
Total educational and general	2,862,415	-	-	2,862,415
Auxiliary enterprises	366,101	-	-	366,101
Medical Center expense	1,351,131	-	-	1,351,131
<b>Total operating expenses</b>	<b>4,579,647</b>	<b>-</b>	<b>-</b>	<b>4,579,647</b>
<b>Increase in net assets from operating activities</b>	<b>551,480</b>	<b>17,697</b>	<b>-</b>	<b>569,177</b>
<b>Nonoperating activities:</b>				
Gifts and pledges	-	-	114,659	114,659
Current year investment returns	279,217	193,815	9,087	482,119
Endowment appreciation utilized	(47,077)	-	-	(47,077)
Changes in funds held by others in perpetuity	-	363	1,702	2,065
Write-offs and disposals of assets	(5,141)	-	-	(5,141)
Nonperiodic change in postretirement benefit plan	(126,985)	-	-	(126,985)
Actuarial adjustment on annuities payable	-	(2,010)	(12,509)	(14,519)
<b>Increase in net assets from nonoperating activities</b>	<b>100,014</b>	<b>192,168</b>	<b>112,939</b>	<b>405,121</b>
<b>Increase in net assets - The Pennsylvania State University</b>	<b>651,494</b>	<b>209,865</b>	<b>112,939</b>	<b>974,298</b>
<b>Noncontrolling interest:</b>				
Excess of revenues over expenses	130	-	-	130
<b>Increase in net assets noncontrolling interest</b>	<b>130</b>	<b>-</b>	<b>-</b>	<b>130</b>
<b>Increase in total net assets</b>	<b>651,624</b>	<b>209,865</b>	<b>112,939</b>	<b>974,428</b>
<b>Net assets at the beginning of the year</b>	<b>5,006,540</b>	<b>484,375</b>	<b>1,218,182</b>	<b>6,709,097</b>
<b>Net assets at the end of the year</b>	<b>\$ 5,658,164</b>	<b>\$ 694,240</b>	<b>\$ 1,331,121</b>	<b>\$ 7,683,525</b>

See notes to consolidated financial statements.

**THE PENNSYLVANIA STATE UNIVERSITY**  
**CONSOLIDATED STATEMENT OF ACTIVITIES**  
**FOR THE YEAR ENDED JUNE 30, 2013**  
**(in thousands)**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Operating revenues and other support:</b>				
Tuition and fees, net of discounts of \$127,987	\$ 1,548,974	\$ -	\$ -	\$ 1,548,974
Commonwealth of Pennsylvania -				
Appropriations	272,431	-	-	272,431
Special contracts	65,712	-	-	65,712
Department of General Services projects	49,890	-	-	49,890
United States Government grants and contracts	503,517	-	-	503,517
Private grants and contracts	182,661	-	-	182,661
Gifts and pledges	74,454	16,827	-	91,281
Endowment spending	71,459	-	-	71,459
Other investment income	100,094	592	-	100,686
Sales and services of educational activities	66,054	-	-	66,054
Recovery of indirect costs	153,662	-	-	153,662
Auxiliary enterprises	378,290	-	-	378,290
Medical Center revenue	1,372,500	-	-	1,372,500
Other sources	15,998	-	-	15,998
Net assets released from restrictions	76,783	(76,783)	-	-
<b>Total operating revenues and other support</b>	<b>4,932,479</b>	<b>(59,364)</b>	<b>-</b>	<b>4,873,115</b>
<b>Operating expenses:</b>				
Educational and general -				
Instruction	1,129,431	-	-	1,129,431
Research	806,333	-	-	806,333
Public service	82,221	-	-	82,221
Academic support	327,327	-	-	327,327
Student services	167,061	-	-	167,061
Institutional support	376,602	-	-	376,602
Total educational and general	2,888,975	-	-	2,888,975
Auxiliary enterprises	347,606	-	-	347,606
Medical Center expense	1,232,710	-	-	1,232,710
<b>Total operating expenses</b>	<b>4,469,291</b>	<b>-</b>	<b>-</b>	<b>4,469,291</b>
<b>Increase/(decrease) in net assets from operating activities</b>	<b>463,188</b>	<b>(59,364)</b>	<b>-</b>	<b>403,824</b>
<b>Nonoperating activities:</b>				
Gifts and pledges	-	-	68,521	68,521
Current year investment returns	56,633	62,315	8,103	127,051
Endowment appreciation utilized	(35,180)	-	-	(35,180)
Changes in funds held by others in perpetuity	-	424	353	777
Write-offs and disposals of assets	(2,000)	-	-	(2,000)
Nonperiodic change in postretirement benefit plan	283,416	-	-	283,416
Actuarial adjustment on annuities payable	-	(1,208)	(3,159)	(4,367)
<b>Increase in net assets from nonoperating activities</b>	<b>302,869</b>	<b>61,531</b>	<b>73,818</b>	<b>438,218</b>
<b>Increase in net assets - The Pennsylvania State University</b>	<b>766,057</b>	<b>2,167</b>	<b>73,818</b>	<b>842,042</b>
<b>Noncontrolling interest:</b>				
Excess of revenues over expenses	57	-	-	57
<b>Increase in net assets noncontrolling interest</b>	<b>57</b>	<b>-</b>	<b>-</b>	<b>57</b>
<b>Increase in total net assets</b>	<b>766,114</b>	<b>2,167</b>	<b>73,818</b>	<b>842,099</b>
<b>Net assets at the beginning of the year</b>	<b>4,240,426</b>	<b>482,208</b>	<b>1,144,364</b>	<b>5,866,998</b>
<b>Net assets at the end of the year</b>	<b>\$ 5,006,540</b>	<b>\$ 484,375</b>	<b>\$ 1,218,182</b>	<b>\$ 6,709,097</b>

See notes to consolidated financial statements.

**THE PENNSYLVANIA STATE UNIVERSITY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**  
**(in thousands)**

	<u>June 30, 2014</u>	<u>June 30, 2013</u>
<b>Cash flows from operating activities:</b>		
Increase in net assets	\$ 974,428	\$ 842,099
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Actuarial adjustment on annuities payable	14,519	4,366
Contributions restricted for long-term investment	(115,854)	(100,126)
Interest and dividends restricted for long-term investment	(60,684)	(61,553)
Net realized and unrealized gains on long-term investments	(512,770)	(132,907)
Depreciation expense	275,369	251,407
Amortization expense	536	480
(Gain)/loss on early extinguishment of debt	25	(213)
Write-offs and disposals of assets	4,693	16,000
Contributions of land, buildings and equipment	(27,089)	(14,821)
Buildings and equipment provided by Pennsylvania Department of General Services	(222)	(1,293)
Contribution to government student loan funds	431	154
Provision for bad debts	54,115	49,433
Increase in deposits held for others	(12,848)	(40,601)
Increase in receivables	(132,791)	(90,238)
Increase in inventories	(4,013)	(503)
(Increase)/decrease in prepaid expenses and other assets	(5,725)	14,598
(Decrease)/increase in accounts payable and other accrued expenses	(68,638)	80,820
Increase in deferred revenue	1,184	18,564
Increase/(decrease) in accrued postretirement benefits	205,365	(169,858)
<b>Net cash provided by operating activities</b>	<u>590,031</u>	<u>665,808</u>
<b>Cash flows from investing activities:</b>		
Purchase of land, buildings and equipment	(450,139)	(434,933)
Advances on student loans	(11,013)	(9,836)
Collections on student loans	8,983	8,320
Proceeds from sale of donated financial assets	159	-
Purchase of investments	(39,148,432)	(40,907,840)
Proceeds from sale of investments	<u>38,919,400</u>	<u>40,068,438</u>
<b>Net cash used in investing activities</b>	<u>(681,042)</u>	<u>(1,275,851)</u>
<b>Cash flows from financing activities:</b>		
Contributions restricted for long-term investment	115,854	100,126
Interest and dividends restricted for long-term investment	60,684	61,553
Payments of annuity obligations	(5,620)	(5,297)
Proceeds from notes payable	10,000	-
Principal payments on notes, bonds and capital leases	(45,322)	(163,604)
Proceeds related to government student loan funds, net of collection costs	<u>688</u>	<u>658</u>
<b>Net cash provided by/(used in) financing activities</b>	<u>136,284</u>	<u>(6,564)</u>
<b>Net increase/(decrease) in cash and cash equivalents</b>	45,273	(616,607)
<b>Cash and cash equivalents at the beginning of the year</b>	<u>983,256</u>	<u>1,599,863</u>
<b>Cash and cash equivalents at the end of the year</b>	<u>\$ 1,028,529</u>	<u>\$ 983,256</u>

Supplemental disclosures of cash flow information (Note 2)

See notes to consolidated financial statements.

**THE PENNSYLVANIA STATE UNIVERSITY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

**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 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 significant transactions between the University, TMSHMC 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 permanently restricted, temporarily restricted or unrestricted.

*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 net present values.

*Temporarily restricted* net assets consist of contributions receivable and remainder interests whose ultimate use is not permanently restricted. In addition, the excess of current market value over the historical cost of permanently restricted endowments is classified as temporarily restricted net assets.

*Unrestricted* net assets are all the remaining net assets of the University. Net unrealized losses on permanently restricted endowment funds for which historical cost exceeds market value are recorded as a reduction to unrestricted net assets.

Revenue from temporarily restricted sources is reclassified as unrestricted revenue when the circumstances of the restriction have been fulfilled. Donor-restricted revenues whose restrictions are met within the same fiscal year are reported as unrestricted income.

### 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 in the fiscal year in which the substantial portion of the educational term occurs. Institutional financial aid provided by the University for tuition and fees is reflected as a reduction of tuition and fee revenue. 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 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 with the revenue assigned to the appropriate category of restriction. The amounts are present valued based on timing of expected collections.

TMSHMC and Health System have agreements with third-party payors that provide for payments to TMSHMC and Health System 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 \$50.1 million and \$43.6 million for the years ended June 30, 2014 and 2013, 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.

TMSHMC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. The Medical Center does not pursue collection of amounts determined to qualify as charity care; they are not reported as net patient service revenue. The amounts of direct and indirect costs for services and supplies furnished under the Medical Center's charity care policy totaled approximately \$20.2 million and \$20.0 million for the years ended June 30, 2014 and 2013, respectively, and is based on a ratio of the Medical Center's operational costs to its gross charges. The amount of charges foregone for services and supplies furnished under the Medical Center's charity policy during 2014 and 2013 totaled approximately \$56.3 million and \$54.9 million, respectively.

### 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, 2014 and 2013. 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, 2014 and 2013 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 3. The fair value of the University's bonds payable is disclosed in Note 7. See Note 5 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:

<i>(in thousands of dollars)</i>	<u>2014</u>	<u>2013</u>
Interest paid	\$ 44,673	\$ 46,798
Non-cash acquisitions of land, buildings and equipment	38,470	32,723

Capitalized costs accrued related to construction are \$46.2 million and \$44.8 million as of June 30, 2014 and 2013, respectively. Taxes paid for 2014 and 2013 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 three months but less than 12 months.

Accounts Receivable

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

<i>(in thousands of dollars)</i>	<u>2014</u>	<u>2013</u>
Grants and contracts, net of allowance of \$1,211 and \$1,241	\$ 222,981	\$ 166,963
Patient accounts receivable, net of allowance of \$60,108 and \$54,759	172,104	173,582
Student receivables, net of allowance of \$6,689 and \$6,434	30,946	33,178
Investment and interest receivable	58,765	78,419
Other, net of allowance of \$4,949 and \$4,540	42,417	40,262
Total accounts receivable, net	<u>\$ 527,213</u>	<u>\$ 492,404</u>

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 Medical Center and Health System records a provision for bad debts in the period of service on the basis of its 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 have a grace period until repayment is required based upon the earlier of graduation or no longer achieving at least half-time enrollment status. The grace period varies depending on the type of loan. Loans accrue interest after the grace period and are repaid directly to the University. Loans to students are uncollateralized and carry default risk. At June 30, 2014 and 2013, student loans represent 0.5% and 0.6% of total assets, respectively.



The availability of funds for loans under federal government revolving loan programs is dependent on reimbursements to the pool from repayments of outstanding loans. Funds advanced by the federal government of \$46.3 million and \$45.3 million at June 30, 2014 and 2013, respectively, are ultimately refundable to the government and are classified as liabilities in the consolidated statements of financial position. Outstanding loans cancelled under the program result in a reduction of the funds available to loan and a decrease in the liability to the federal government.

At June 30, 2014 and 2013, loans to students consisted of the following:

<i>(in thousands of dollars)</i>	<u>2014</u>	<u>2013</u>
Loans to students:		
Federal government loan programs:		
Perkins loan program	\$ 44,337	\$ 42,789
Health Professions Student Loans and Loans for Disadvantaged Students	<u>117</u>	<u>197</u>
Federal government loan programs	44,454	42,986
Institutional loan programs	<u>19,066</u>	<u>18,939</u>
	63,520	61,925
Less allowance for doubtful accounts:		
Balance, beginning of year	(3,081)	(2,733)
Provision for doubtful accounts	<u>378</u>	<u>(348)</u>
Balance, end of year	<u>(2,703)</u>	<u>(3,081)</u>
Loans to students, net	<u>\$ 60,817</u>	<u>\$ 58,844</u>

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, 2014 and 2013 are as follows:

	<i>(in thousands of dollars)</i>				
<u>2014</u>	<u>30 days or less</u>	<u>31-60 days</u>	<u>61-90 days</u>	<u>Over 91 days</u>	<u>Total</u>
Loans to students:					
Federal government loan programs	\$ 42,955	\$ 705	\$ 64	\$ 730	\$ 44,454
Institutional loan programs	<u>18,271</u>	<u>239</u>	<u>34</u>	<u>522</u>	<u>19,066</u>
Total loans to students	<u>61,226</u>	<u>944</u>	<u>98</u>	<u>1,252</u>	<u>63,520</u>
Allowance for doubtful accounts:					
Federal government loan programs					(1,297)
Institutional loan programs					<u>(1,406)</u>
Total allowance for doubtful accounts					<u>(2,703)</u>
Total loans to students, net					<u>\$ 60,817</u>

	(in thousands of dollars)				
	30 days or less	31-60 days	61-90 days	Over 91 days	Total
<u>2013</u>					
Loans to students:					
Federal government loan programs	\$ 41,367	\$ 656	\$ 86	\$ 877	\$ 42,986
Institutional loan programs	<u>18,310</u>	<u>280</u>	<u>23</u>	<u>326</u>	<u>18,939</u>
Total loans to students	<u>59,677</u>	<u>936</u>	<u>109</u>	<u>1,203</u>	<u>61,925</u>
Allowance for doubtful accounts:					
Federal government loan programs					(1,432)
Institutional loan programs					<u>(1,649)</u>
Total allowance for doubtful accounts					<u>(3,081)</u>
Total loans to students, net					<u>\$ 58,844</u>

Inventories

Inventories are stated at the lower of cost or market, generally 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 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, 2014 and 2013. 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 permanently restricted net assets 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:

<i>(in thousands of dollars)</i>	<u>2014</u>	<u>2013</u>
Land	\$ 123,532	\$ 116,050
Buildings	5,354,902	5,043,463
Improvements other than buildings	587,492	559,877
Equipment	<u>1,186,744</u>	<u>1,100,431</u>
Total plant	7,252,670	6,819,821
Less accumulated depreciation	<u>(3,308,418)</u>	<u>(3,089,057)</u>
Total investment in plant, net	<u>\$ 3,944,252</u>	<u>\$ 3,730,764</u>

The value of land, buildings, and equipment is recorded at cost or, if received as gifts, at fair value at date of gift. 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 \$275.4 million and \$251.4 million for the fiscal years ended June 30, 2014 and 2013, 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 term or the estimated useful life of the asset. The capitalized cost and accumulated depreciation of the leases at June 30, 2014 and 2013 was \$127.9 million and \$42.5 million, and \$135.5 million and \$41.8 million, respectively.

Accounts Payable and Other Accrued Expenses

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

<i>(in thousands of dollars)</i>	<u>2014</u>	<u>2013</u>
Accounts payable (non-Medical Center)	\$ 231,910	\$ 366,637
Medical Center accounts payable and other accrued expenses	186,570	187,667
Accrued payroll and other related liabilities	89,851	87,300
Accrued bond interest	13,093	13,674
Student deposits	<u>5,391</u>	<u>4,818</u>
Total accounts payable and other accrued expenses	<u>\$ 526,815</u>	<u>\$ 660,096</u>

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

Under ASC 410-20, *Asset Retirement and Environmental Obligations – Asset Retirement Obligations*, organizations must accrue for costs related to legal obligations to perform certain activities in connection with retirement, disposal, or abandonment of assets. The obligation to perform the asset retirement activity is not conditional even though the timing or method may be conditional.

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, 2012	\$ 61,934
Accretion expense	7,651
Liabilities settled	<u>(4,293)</u>
Balance as of June 30, 2013	65,292
Accretion expense	5,229
Liabilities settled	<u>(4,188)</u>
Balance as of June 30, 2014	<u>\$ 66,333</u>

### 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.

### 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 740 Income Taxes Topic, the University continues to evaluate tax positions and has determined there is no material impact on the University financial statements.

### Recent Accounting Pronouncements

In October 2012, the FASB issued ASU 2012-05, *"Statement of Cash Flows (Topic 230): Not-for-Profit Entities: Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows."* This guidance provides clarification on how entities classify cash receipts arising from the sale of certain donated financial assets in the statement of cash flows. This guidance is effective for the University beginning July 1, 2013. The adoption of this guidance did not have a material impact on its consolidated statement of cash flows.

In January 2013, the FASB issued ASU 2013-01, *"Clarifying the Scope of Disclosures About Offsetting Assets and Liabilities."* This guidance provides clarification on the scope of the offsetting disclosure requirements in ASU 2011-11. This guidance is effective for the University beginning July 1, 2013. The adoption of this guidance did not have a material impact on its consolidated financial statements.

In February 2013, the FASB issued ASU 2013-04, *"Obligations Resulting From Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date."* This guidance requires entities to measure obligations resulting from the joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date. This guidance is effective for the University beginning July 1, 2014 with early adoption permitted. The University has not yet evaluated the impact this guidance may have on its consolidated financial statements.

In April 2013, the FASB issued ASU 2013-06, *"Services Received from Personnel of an Affiliate."* This update specifies guidance for not-for-profit entities to apply in recognizing and measuring services received from personnel of an affiliate. This guidance is effective for the University beginning after June 15, 2014 with early adoption permitted. The University has not yet evaluated the impact this guidance may have on its consolidated financial statements.

### 3. INVESTMENTS

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

<i>(in thousands of dollars)</i>	<u>2014</u>	<u>2013</u>
Money markets	\$ 213,878	\$ 371,987
Fixed income:		
U.S. government/agency	1,190,248	1,174,609
U.S. corporate	803,990	706,291
Foreign	408,364	372,515
Other	169,962	146,617
Equities	1,742,632	1,342,487
Private capital	<u>1,155,812</u>	<u>902,728</u>
Total	<u>\$ 5,684,886</u>	<u>\$ 5,017,234</u>

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, which are fully cash collateralized, comprise the University's directly held derivative instruments at June 30, 2014 and 2013, respectively, are marked to market daily and are included in the fair value of the University's investments. 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 \$172.8 million, 3.0% of total investments, and \$270.5 million, 5.4% of total investments at June 30, 2014 and 2013, respectively. The University's derivatives consist of S&P 500 and Treasury futures 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:

<i>(in thousands of dollars)</i>	<u>2014</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Dividends and interest	\$ 141,655	\$ 141,655	\$ 674	\$ 9,087	\$ 151,416
Net realized gains	45,538	45,538	28,535	-	74,073
Net unrealized gains	<u>233,679</u>	<u>233,679</u>	<u>165,280</u>	<u>-</u>	<u>398,959</u>
Total returns	<u>\$ 420,872</u>	<u>\$ 420,872</u>	<u>\$ 194,489</u>	<u>\$ 9,087</u>	<u>\$ 624,448</u>

<i>(in thousands of dollars)</i>	<u>2013</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Dividends and interest	\$ 136,373	\$ 136,373	\$ 592	\$ 8,103	\$ 145,068
Net realized gains	38,563	38,563	21,898	-	60,461
Net unrealized gains	<u>18,070</u>	<u>18,070</u>	<u>40,417</u>	<u>-</u>	<u>58,487</u>
Total returns	<u>\$ 193,006</u>	<u>\$ 193,006</u>	<u>\$ 62,907</u>	<u>\$ 8,103</u>	<u>\$ 264,016</u>

#### 4. 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 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. Funds functioning as endowments are established at the direction of University management and 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, 2014 and 2013 was \$1.0 million and \$2.5 million, 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:

(in thousands of dollars)

<u>2014</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (959)	\$ 521,680	\$ 1,146,955	\$ 1,667,676
Funds functioning as endowments	<u>596,738</u>	<u>-</u>	<u>-</u>	<u>596,738</u>
Total net assets	<u>\$ 595,779</u>	<u>\$ 521,680</u>	<u>\$ 1,146,955</u>	<u>\$ 2,264,414</u>

(in thousands of dollars)

<u>2013</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (2,530)	\$ 338,970	\$ 1,067,081	\$ 1,403,521
Funds functioning as endowments	<u>520,622</u>	<u>-</u>	<u>-</u>	<u>520,622</u>
Total net assets	<u>\$ 518,092</u>	<u>\$ 338,970</u>	<u>\$ 1,067,081</u>	<u>\$ 1,924,143</u>



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

<i>(in thousands of dollars)</i>					
<u>2014</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>	
Endowment net assets, beginning of the year	\$ 518,092	\$ 338,970	\$ 1,067,081	\$ 1,924,143	
Endowment return:					
Endowment earnings	28,306	20	3,054	31,380	
Net realized gains	47,077	28,374	-	75,451	
Net unrealized gains	63,399	155,123	-	218,522	
Reclassification of funds with deficiencies	<u>1,571</u>	<u>(1,571)</u>	<u>-</u>	<u>-</u>	
Total endowment return	<u>140,353</u>	<u>181,946</u>	<u>3,054</u>	<u>325,353</u>	
Contributions	-	764	76,820	77,584	
Endowment spending	(75,383)	-	-	(75,383)	
Transfers to create funds functioning as endowments	<u>12,717</u>	<u>-</u>	<u>-</u>	<u>12,717</u>	
Endowment net assets, end of the year	<u>\$ 595,779</u>	<u>\$ 521,680</u>	<u>\$ 1,146,955</u>	<u>\$ 2,264,414</u>	
<i>(in thousands of dollars)</i>					
<u>2013</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>	
Endowment net assets, beginning of the year	\$ 486,802	\$ 284,539	\$ 1,001,580	\$ 1,772,921	
Endowment return:					
Endowment earnings	36,279	80	3,605	39,964	
Net realized gains	35,180	21,351	-	56,531	
Net unrealized losses	20,830	34,900	-	55,730	
Reclassification of funds with deficiencies	<u>2,405</u>	<u>(2,405)</u>	<u>-</u>	<u>-</u>	
Total endowment return	<u>94,694</u>	<u>53,926</u>	<u>3,605</u>	<u>152,225</u>	
Contributions	-	505	61,896	62,401	
Endowment spending	(71,459)	-	-	(71,459)	
Transfers to create funds functioning as endowments	<u>8,055</u>	<u>-</u>	<u>-</u>	<u>8,055</u>	
Endowment net assets, end of the year	<u>\$ 518,092</u>	<u>\$ 338,970</u>	<u>\$ 1,067,081</u>	<u>\$ 1,924,143</u>	

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 2014 and 2013) 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.

## 5. 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 2 measures include University interests in certain debt instruments and commingled investment funds which NAV is used as a practical expedient. These funds are redeemable at NAV as of the measurement date, generally within 90 days.
- Level 3 – Unobservable inputs that cannot be corroborated by observable market data. Level 3 instruments primarily consist of investment funds for which NAV is used as a practical expedient. The University does not have the ability to redeem the funds at NAV as of the measurement date.

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, 2014 about the University's financial assets and liabilities that are measured at fair value on a recurring basis:

<i>(in thousands of dollars)</i>	Quoted Prices in Active Markets For Identical Assets <u>Level 1</u>	Significant Other Observable Inputs <u>Level 2</u>	Significant Unobservable Inputs <u>Level 3</u>	Total Fair Value
<b>Assets:</b>				
Long-term Investment Pool:				
Money markets	\$ 48,692	\$ 160,388	\$ -	\$ 209,080
Fixed income				
U.S. government/agency	85,285	24,447	-	109,732
U.S. corporate	-	96,171	-	96,171
Foreign	64,007	187,203	-	251,210
Other	-	9,679	-	9,679
Equities	906,248	588,246	121,186	1,615,680
Private capital	-	397,295	751,380	1,148,675
Total	<u>\$ 1,104,232</u>	<u>\$ 1,463,429</u>	<u>\$ 872,566</u>	<u>\$ 3,440,227</u>
Operating investments:				
Money markets	\$ 4,592	\$ 206	\$ -	\$ 4,798
Fixed income				
U.S. government/agency	646,086	434,286	144	1,080,516
U.S. corporate	44,646	663,173	-	707,819
Foreign	8,070	149,084	-	157,154
Other	10,627	146,451	3,205	160,283
Equities	124,989	-	1,963	126,952
Private capital	-	-	7,137	7,137
Total	<u>\$ 839,010</u>	<u>\$ 1,393,200</u>	<u>\$ 12,449</u>	<u>\$ 2,244,659</u>
Deposits held by bond trustees:				
Fixed income				
U.S. government/agency	\$ -	\$ 2,551	-	\$ 2,551
Total	<u>\$ -</u>	<u>\$ 2,551</u>	<u>\$ -</u>	<u>\$ 2,551</u>
Beneficial interest in perpetual trusts				
	\$ -	\$ -	\$ 15,498	\$ 15,498
<b>Liabilities:</b>				
Present value of annuities payable	\$ -	\$ -	\$ 51,151	\$ 51,151

The following table presents information as of June 30, 2013 about the University's financial assets and liabilities that are measured at fair value on a recurring basis:

<i>(in thousands of dollars)</i>	Quoted Prices in Active Markets For Identical Assets <u>Level 1</u>	Significant Other Observable Inputs <u>Level 2</u>	Significant Unobservable Inputs <u>Level 3</u>	Total Fair Value
<b>Assets:</b>				
Long-term Investment Pool:				
Money markets	\$ 86,754	\$ 261,667	\$ -	\$ 348,421
Fixed income				
U.S. government/agency	84,168	29,967	-	114,135
U.S. corporate	4,229	83,480	-	87,709
Foreign	60,260	174,985	-	235,245
Other	-	8,913	-	8,913
Equities	822,353	373,406	63,157	1,258,916
Private capital	-	307,741	588,922	896,663
Total	<u>\$ 1,057,764</u>	<u>\$ 1,240,159</u>	<u>\$ 652,079</u>	<u>\$ 2,950,002</u>
Operating investments:				
Money markets	\$ 23,360	\$ 206	\$ -	\$ 23,566
Fixed income				
U.S. government/agency	574,415	485,921	138	1,060,474
U.S. corporate	-	618,582	-	618,582
Foreign	-	137,270	-	137,270
Other	-	134,890	2,814	137,704
Equities	81,470	798	1,303	83,571
Private capital	-	-	6,065	6,065
Total	<u>\$ 679,245</u>	<u>\$ 1,377,667</u>	<u>\$ 10,320</u>	<u>\$ 2,067,232</u>
Deposits held by bond trustees:				
Fixed income				
U.S. government/agency	\$ -	\$ 2,551	-	\$ 2,551
Total	<u>\$ -</u>	<u>\$ 2,551</u>	<u>\$ -</u>	<u>\$ 2,551</u>
Beneficial interest in perpetual trusts	\$ -	\$ -	\$ 13,252	\$ 13,252
<b>Liabilities:</b>				
Present value of annuities payable	\$ -	\$ -	\$ 42,255	\$ 42,255

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, 2014 and 2013, fair value of endowment funds and funds functioning as endowments within the LTIP totaled \$2,294.6 million and \$1,941.1 million, respectively. At June 30, 2014 and 2013, fair value of operating funds included in the LTIP totaled \$1,145.6 million and \$1,008.9 million, respectively.

The following tables present information related to changes in Level 3 for each category of assets and liabilities for year ended June 30, 2014:

<i>(in thousands of dollars)</i>	<u>Long-term Investment Pool</u>	<u>Operating Investments</u>	<u>Beneficial Interest in Perpetual Trusts</u>
<b>Assets:</b>			
Beginning balance	\$ 652,079	\$ 10,320	\$ 13,252
Total realized and unrealized gains	175,790	1,454	2,035
Purchases	175,566	747	291
Sales	(130,869)	(72)	(80)
Transfers into (out of) Level 3	-	-	-
Ending balance	<u>\$ 872,566</u>	<u>\$ 12,449</u>	<u>\$ 15,498</u>
	<u>Present Value of Annuities Payable</u>		
<b>Liabilities:</b>			
Beginning balance	\$ 42,255		
Actuarial adjustment of liability	(633)		
Gifts	10,135		
Sales	(606)		
Withdrawal from program	-		
Ending balance	<u>\$ 51,151</u>		

The following tables present information related to changes in Level 3 for each category of assets and liabilities for year ended June 30, 2013:

<i>(in thousands of dollars)</i>	<u>Long-term Investment Pool</u>	<u>Operating Investments</u>	<u>Beneficial Interest in Perpetual Trusts</u>
<b>Assets:</b>			
Beginning balance	\$ 607,407	\$ 10,778	\$ 12,891
Total realized and unrealized Gains/(losses)	60,065	(388)	361
Purchases	165,678	75	-
Sales	(135,294)	(145)	-
Transfers into (out of) Level 3	(45,777)	-	-
Ending balance	<u>\$ 652,079</u>	<u>\$ 10,320</u>	<u>\$ 13,252</u>
	<u>Present Value of Annuities Payable</u>		
<b>Liabilities:</b>			
Beginning balance	\$ 43,167		
Actuarial adjustment of liability	4,679		
Gifts	642		
Sales	(6,233)		
Withdrawal from program	-		
Ending balance	<u>\$ 42,255</u>		

For the year ended June 30, 2014, there were no transfers of assets between Level 3 and Level 2. For the year ended June 30, 2013, \$45.8 million of Level 3 assets were transferred to Level 2 as a result of the expiration of lock-up periods for two marketable alternative funds; now these investments may be redeemed within 90 days of June 30.

There were no transfers of investments between Level 1 and Level 2 in 2014 and 2013.

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, 2014:

<i>(in thousands of dollars)</i>	<u>Fair Value</u>	<u>Unfunded Commitment</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
Commingled Funds:			Quarterly/ Daily/Monthly	5-90 days
Non-U.S. Equity	\$ 617,223			
Subtotal	<u>\$ 617,223</u>			
Marketable Investment Partnerships:				
Absolute Return	\$ 17,135		Quarterly	65 days
Distressed Debt	58,506		Quarterly/ Semi Annual	60-90 days
Commodities	106,388		Monthly	30-60 days
Opportunistic	171,103		Quarterly	30 days
Directional Long/Short	62,818		Monthly	30 days
Subtotal	<u>\$ 415,950</u>			
Non-Marketable Investment Partnerships:				
Private Real Estate	\$ 101,360	\$ 45,193		
Venture Capital	213,012	112,579		
Private Equity	248,263	211,614		
Natural Resources	131,240	77,675		
Private Debt	45,987	51,040		
Subtotal	<u>\$ 739,862</u>	<u>\$ 498,101</u>		
Total	<u>\$ 1,773,035</u>	<u>\$ 498,101</u>		

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, 2013:

<i>(in thousands of dollars)</i>	<u>Fair Value</u>	<u>Unfunded Commitment</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
Commingled Funds:			Quarterly/ Daily/Monthly	5-90 days
Non-U.S. Equity	\$ 362,061			
Subtotal	<u>\$ 362,061</u>			
Marketable Investment Partnerships:				
Absolute Return	\$ 20,173		Quarterly	65 days
Distressed Debt	52,152		Quarterly/ Semi Annual	60-90 days
Commodities	84,271		Monthly	30-60 days
Opportunistic	140,181		Quarterly	30 days
Directional Long/Short	27,580		Quarterly	30-90 days
Subtotal	<u>\$ 324,357</u>			
Non-Marketable Investment Partnerships:				
Private Real Estate	\$ 88,567	\$ 19,788		
Venture Capital	144,712	83,095		
Private Equity	234,203	141,606		
Natural Resources	91,306	69,809		
Private Debt	19,583	20,031		
Subtotal	<u>\$ 578,371</u>	<u>\$ 334,329</u>		
Total	<u>\$ 1,264,789</u>	<u>\$ 334,329</u>		



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. 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. One commingled fund has 2 years remaining on a 3-year gate and a second is 50% redeemable in three years. The two make up approximately 12.9% and 6.8%, respectively of commingled portfolio.

Marketable Investment Funds 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 Long Term Investment Pool's (LTIP) share holdings in the fund. Five major investment strategies are included within this category. Absolute Return refers to relative value strategies. Directional refers to equity long/short strategies in both U.S. and non-U.S. markets. Opportunistic refers to global multi-strategy. 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.

Nonmarketable 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, 2014 and 2013, respectively. 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.

## 6. CONTRIBUTIONS RECEIVABLE

Contributions receivable are summarized as follows as of June 30:

<i>(in thousands of dollars)</i>	<u>2014</u>	<u>2013</u>
In one year or less	\$ 71,374	\$ 57,002
Between one year and five years	79,253	63,742
More than five years	<u>133,163</u>	<u>119,990</u>
	283,790	240,734
Less allowance	(6,911)	(5,704)
Less discount	<u>(62,415)</u>	<u>(56,893)</u>
Contributions receivable, net	<u>\$ 214,464</u>	<u>\$ 178,137</u>

Contributions receivable are discounted at rates ranging from 0.11% to 2.81% and 0.15% to 2.87% at June 30, 2014 and 2013, respectively. The discount rates for prior periods ranged from 0.15% to 6.28%.

At June 30, 2014 and 2013, the University has received bequest intentions and certain other conditional promises to give of \$98.2 million and \$85.8 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, 2014:

	(in thousands of dollars)
Balance beginning of year	\$ 178,137
New pledges	115,112
Collections on pledges	(72,056)
Increase in allowance	(1,207)
Increase in unamortized discounts	(5,522)
Balance at the end of year	<u>\$ 214,464</u>

## 7. LONG-TERM DEBT

The various bond issues 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)	<u>2014</u>	<u>2013</u>
<u>The Pennsylvania State University Bonds</u>		
Series 2010	\$ 135,035	\$ 135,035
Series 2009A	107,840	114,075
Series 2009B	74,235	74,235
Series 2008A	77,670	77,670
Series 2008B	3,035	3,980
Series 2007A	87,595	88,125
Series 2007B	60,630	63,515
Series 2005	83,650	85,700
Series 2004A	51,475	52,835
Refunding Series 2002	25,960	41,655
<u>Pennsylvania Higher Educational Facilities</u>		
<u>Authority University Revenue Bonds</u>		
<u>(issued for The Pennsylvania State</u>		
<u>University)</u>		
Series 2006	3,335	3,545
Series 2004	3,655	3,905
Series 2002	3,650	4,020
<u>Lycoming County Authority College</u>		
<u>Revenue Bonds (issued for Penn</u>		
<u>College)</u>		
Series 2012	24,685	24,685
Series 2011	39,050	39,050
Series 2008	55,000	55,000
Series 2005	10,060	11,085
Series 1993	<u>3,500</u>	<u>5,250</u>
Total bonds payable	850,060	883,365
Unamortized bond premiums	35,273	38,008
<u>Note payable and capital leases</u>		
Note payable	10,000	-
Capital lease obligations	<u>86,155</u>	<u>84,035</u>
Total notes payable and capital leases	<u>96,155</u>	<u>84,035</u>
Total long-term debt	<u>\$ 981,488</u>	<u>\$ 1,005,408</u>

<u>Debt issuance</u>	<u>Interest rate mode</u>	<u>Interest rates</u>	<u>Payment ranges and maturity</u> <i>(in thousands of dollars)</i>
<b>The Pennsylvania State University Bonds</b>			
			\$3,655 to \$6,595 through March 2030 with \$21,805 and \$44,245 due March 2035 and 2040
Series 2010	Fixed	3.375% - 5.00%	
Series 2009A	Fixed	4.00% - 5.00%	\$5,540 to \$9,320 through March 2029
Series 2009B	Variable	0.15%	June 2031
Series 2008A	Fixed	5.00%	\$1,840 to \$7,695 through August 2029
Series 2008B	Fixed	3.50% - 3.75%	\$975 to \$1,050 through August 2016
			\$550 to \$700 through August 2022, with \$11,115 and \$70,905 due August 2028 and 2036
Series 2007A	Fixed	3.70% - 4.50%	
Series 2007B	Fixed	5.00% - 5.25%	\$3,030 to \$5,955 through August 2027
			\$2,150 to \$2,745 through September 2019 with \$15,990, \$20,550, and \$32,485 due September 2024, 2029, and 2035
Series 2005	Fixed	3.75% - 5.00%	
			\$1,425 to \$1,825 through September 2019, with \$10,625, \$13,635, and \$17,515 due September 2024, 2029, and 2034
Series 2004A	Fixed	4.50% - 5.00%	
Refunding Series 2002	Fixed	5.25%	\$4,585 to \$16,540 through August 2016
<b>Pennsylvania Higher Education Facilities Authority ("PHEFA") University Revenue Bonds</b>			
			\$220 to \$280 through 2020, with \$1,610 due September 2025
Series 2006	Fixed	4.10% - 5.125%*	
			\$260 to \$325 through 2019, with \$1,905 due September 2024
Series 2004	Fixed	4.30% - 5.00%*	
			\$385 to \$425 due through 2017, with \$2,435 due March 2022
Series 2002	Fixed	4.40% - 5.00%*	
* Annual interest costs to the University for interest rates greater than 3.00% are subsidized by PHEFA.			
<b>Lycoming County Authority College Revenue Bonds</b>			
Series 2012	Fixed	2.00% - 5.00%	\$410 to \$2,635 through May 2032
Series 2011	Fixed	3.00% - 5.50%	\$70 to \$5,230 through July 2030
Series 2008	Fixed	3.50% - 5.50%	\$1,455 to \$4,140 through October 2037
Series 2005	Fixed	5.00%	\$505 to \$1,855 through January 2025
Series 1993	Fixed	6.15%	\$450 to \$478 through November 2015

The Series 2009B Bonds are currently paying interest on a variable rate basis at a long term rate for the period June 1, 2014 through May 31, 2015. 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 0.15% 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.

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

<u>Year</u>	<u>Annual Installments</u> (in thousands of dollars)
2015	\$ 35,330
2016	24,320
2017	28,780
2018	24,455
2019	28,805
Thereafter	<u>708,370</u>
	<u>\$ 850,060</u>

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, 2014, the carrying value and estimated fair value of the University's bonds payable, including issuance premiums, are \$885.3 million and \$917.8 million, respectively. At June 30, 2013, the carrying value and estimated fair value of the University's bonds payable, including issuance premiums, were \$921.4 million and \$939.4 million, respectively. Certain bond issues have associated issuance premiums, these issuance premiums total \$35.3 million and \$38.0 million at June 30, 2014 and 2013, 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 \$10 million note payable due annually through June 2024 is included within the consolidated statements of financial position at June 30, 2014. The note payable bears interest at 2.60%.

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, 2014 are as follows:

<u>Year</u>	<u>(in thousands of dollars)</u>
2015	\$ 15,010
2016	13,895
2017	12,888
2018	10,253
2019	8,244
Thereafter	<u>132,232</u>
Total minimum lease payments	192,522
Less imputed interest	<u>(106,367)</u>
Capital lease obligation	86,155
Current portion	<u>9,265</u>
Long-term portion	<u>\$ 76,890</u>

## 8. OPERATING LEASES

The University has certain lease agreements in effect which are considered operating leases. During the year ended June 30, 2014, the University recorded expenses of \$21.0 million for leased equipment and \$24.7 million for leased building space. During the year ended June 30, 2013, the University recorded expenses of \$22.0 million for leased equipment and \$22.6 million for leased building space.

Future minimum lease payments under operating leases as of June 30, 2014 are as follows:

<u>Year</u>	<i>(in thousands of dollars)</i>
2015	\$ 22,532
2016	16,534
2017	13,149
2018	10,057
2019	8,587
Thereafter	<u>37,490</u>
Total minimum lease payments	<u>\$ 108,349</u>

## 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 (\$50.9 million and \$35.9 million for the years ended June 30, 2014 and 2013, respectively). The University's total cost for retirement benefits, included in expenses, is \$168.1 million and \$146.6 million for the years ended June 30, 2014 and 2013, respectively.

## 10. POSTRETIREMENT BENEFITS

The University sponsors a retiree medical plan covering eligible retirees and eligible dependents. This program includes a Preferred Provider Organization ("PPO") plan for retirees and their dependents who are not eligible for Medicare, a Medicare Advantage PPO plan and a Medicare Supplement plan. In addition, the University provides retiree life insurance benefits at no cost to the retiree.

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

- 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
- 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 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 Medicare Advantage PPO plan and the Medicare Supplement plan 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 Penn State Retirement Savings 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 unrestricted net assets at June 30, 2014 and 2013 are the following amounts that have not yet been recognized in net periodic postretirement cost: unrecognized prior service cost (benefit) of (\$64.6) million and (\$86.3) million and unrecognized actuarial loss of \$652.9 million and \$547.6 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)

	<u>2014</u>	<u>2013</u>
Benefit obligation at beginning of year	\$ 1,695,041	\$ 1,864,899
Service cost	44,844	56,194
Interest cost	78,696	77,943
Actuarial gain	(88,390)	(95,754)
Benefits paid	(47,661)	(43,840)
Plan assumptions	<u>217,876</u>	<u>(164,401)</u>
Benefit obligation at end of year	<u>\$ 1,900,406</u>	<u>\$ 1,695,041</u>

Change in plan assets:

(in thousands of dollars)

	<u>2014</u>	<u>2013</u>
Fair value of plan assets at beginning of year	\$ -	\$ -
Employer contributions	47,661	43,840
Benefits paid	<u>(47,661)</u>	<u>(43,840)</u>
Fair value of plan assets at end of year	<u>\$ -</u>	<u>\$ -</u>
Funded status	\$ (1,900,406)	\$ (1,695,041)
Unrecognized prior service cost (benefit)	-	-
Unrecognized net actuarial loss	-	-
Accrued postretirement benefit expense	<u>\$ (1,900,406)</u>	<u>\$ (1,695,041)</u>

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

(in thousands of dollars)

	<u>2014</u>	<u>2013</u>
Service cost	\$ 44,844	\$ 56,194
Interest cost	78,696	77,943
Amortization of prior service cost	(21,699)	(21,699)
Amortization of unrecognized net loss	<u>24,200</u>	<u>44,960</u>
Net periodic postretirement cost	<u>\$ 126,041</u>	<u>\$ 157,398</u>

The assumed healthcare cost trend rate used in measuring the accumulated postretirement benefit obligation was 7.50% and 8.00% for the years ended June 30, 2014 and 2013, respectively, reduced by 0.50% per year to a fixed level of 5.00%. The weighted average postretirement benefit obligation discount rate was 4.50% and 5.00% for the years ended June 30, 2014 and 2013, respectively.

If the healthcare cost trend rate assumptions were increased by 1% in each year, the accumulated postretirement benefit obligation would be increased by \$367.2 million and \$318.1 million as of June 30, 2014 and 2013, 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 \$27.4 million and \$32.3 million as of June 30, 2014 and 2013, respectively. If the healthcare cost trend rate assumptions were decreased by 1% in

each year, the accumulated postretirement benefit obligation would be decreased by \$294.3 million and \$256.6 million as of June 30, 2014 and 2013, 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 \$21.0 million and \$24.5 million as of June 30, 2014 and 2013, 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)
2015	\$ 53,350
2016	58,513
2017	63,596
2018	68,020
2019	72,598
2020-24	429,097

## 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. 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. The Health System recorded non-controlling interest related to the acquisition of additional ownership interest in a joint venture. This noncontrolling interest is recorded in the net assets within the consolidated statements of financial position with a value at June 30, 2014 and 2013 of \$961,000 and \$831,000, respectively.

On June 26, 2014, a letter of intent and term sheet ("agreement") was executed between the University, the Medical Center, the Health System and Pinnacle Health System. The purpose of the agreement was to set forth certain non-binding understandings and certain binding agreements between the parties. The intent is to form a new Health Enterprise in central Pennsylvania. This new collaborative innovative enterprise would bring together a high-performing university medical center and a community health system. It would provide increased access to a wider range of services and full spectrum of care to patients over a broad geographic base. Both systems will continue to operate independently and as normal until an integration is finalized and all necessary approvals are obtained.

## 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 \$814.6 million of which \$619.8 million has been paid or accrued as of June 30, 2014. 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 \$19.1 million and \$20.5 million as of June 30, 2014 and 2013, 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. No liabilities related to guarantees have been recorded as of June 30, 2014.

### 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 2% for the years ended June 30, 2014 and 2013, respectively, of the medical malpractice claims liability in the amount of \$96.4 million and \$96.7 million is recorded as of June 30, 2014 and 2013, 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 \$19.7 million and \$20.7 million at June 30, 2014 and 2013, 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 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 \$10.1 million and \$10.9 million, discounted at 0.75%, is recorded as of June 30, 2014 and 2013, respectively. The University has established a trust fund, in the amount of \$12.8 million and \$12.7 million at June 30, 2014 and 2013, 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

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 accrued \$59.7 million for 26 of 32 known claims at June 30, 2013 with such claims subsequently paid during fiscal year 2014. These costs were included in institutional support within the consolidated statement of activities. Two of the claims were deemed to have no merit through the due diligence process. Subsequently, the University has been notified of five additional claims, bringing known claims to 37, two of which were made known to the University subsequent to June 30, 2014. Without having knowledge of the number and nature of unknown claims and in view of the inherent difficulty of predicting the outcome of our remaining eleven known claims, each with their own unique circumstances that give rise to their alleged claims, and given the various stages of the proceedings, we are 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 2014 financial statements for these claims although a loss is reasonably possible in future periods which could have a material adverse effect on our current and future financial position, results of operations and cash flows.



For the years ended June 30, 2014 and 2013, the University has incurred costs, net of insurance reimbursements totaling \$15.6 million and \$17.3 million, respectively, for internal investigation, legal, communications and other related costs. These costs are included in institutional support within the consolidated statement of activities. Insurance reimbursements for the years ended June 30, 2014 and 2013 totaled \$64,000 and \$249,000, respectively. Amounts paid directly by insurance carriers for the years ended June 30, 2014 and 2013 totaled \$2,681,000 and \$2,994,000, respectively.

The University has submitted claims to insurance carriers at June 30, 2014 related to the claims settled and certain legal costs incurred to date. Amounts of future insurance reimbursement are unknown as of June 30, 2014 and as a result no insurance recovery accruals have been recorded in the 2014 financial statements.

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

On July 12, 2013, the University received a preliminary report from the U.S. Department of Education based on the program review of the University's compliance with the Clery Act, a federal law related to campus safety. The Department of Education will make a final program review determination after the process is complete. The outcome and financial impacts of the program review are unknown as of the date the consolidated financial statements were issued.

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.

### **13. SUBSEQUENT EVENTS**

The University has evaluated subsequent events through October 24, 2014, 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.

# THE PENNSYLVANIA STATE UNIVERSITY

## BOARD OF TRUSTEES

as of June 30, 2014

APPOINTED BY THE GOVERNOR	MEMBERS EX OFFICIO	ELECTED BY BOARD REPRESENTING BUSINESS AND INDUSTRY
CLIFFORD G. BENSON, JR. Chief Development Officer Buffalo Sabres	ERIC J. BARRON President The Pennsylvania State University	JAMES S. BROADHURST Chairman Eat'n Park Hospitality Group, Incorporated
KATHLEEN L. CASEY Senior Advisor Patomak Global Partners, LLC	THOMAS W. CORBETT JR. Governor Commonwealth of Pennsylvania*	RICHARD K. DANDREA Attorney Eckert Seamans Cherin & Mellott, LLC
MARK H. DAMBLY President Pennrose Properties, LLC	CAROLYN C. DUMARESQ Acting Secretary Pennsylvania Department of Education	KENNETH C. FRAZIER Chairman, President & Chief Executive Officer Merck & Company, Incorporated
ALLISON S. GOLDSTEIN Graduate Assistant The Pennsylvania State University	ELLEN M. FERRETTI Secretary Pennsylvania Department of Conservation and Natural Resources	EDWARD R. HINTZ, JR. President Hintz Capital Management, Incorporated
TODD L. RUCCI Government and Community Relations Officer PAP Technologies	GEORGE D. GREIG Secretary Pennsylvania Department of Agriculture	KAREN B. PEETZ President Bank of New York Mellon
PAUL H. SILVIS Head Coach SilcoTek	*JENNIFER BRANSTETTER Governor's Non-Voting Representative Director of Policy and Planning Office of the Governor	LINDA B. STRUMPF Retired Chief Investment Officer The Helmsley Charitable Trust
ELECTED BY ALUMNI		ELECTED BY DELEGATES FROM AGRICULTURAL SOCIETIES
MARIANNE E. ALEXANDER President Emerita of the Public Leadership Education Network	RYAN J. MCCOMBIE Retired, United States Navy	DONALD G. COTNER President Cotner Farms, Inc.
H. JESSE ARNELLE Attorney	JOEL N. MYERS President AccuWeather, Incorporated	KEITH W. ECKEL Sole Proprietor and President Fred W. Eckel and Sons Farms, Incorporated
EDWARD "TED" B. BROWN President & CEO KETCHConsulting, Inc.	WILLIAM F. OLDSEY Independent Consultant/Educational Publishing; Operating Partner, Atlas Advisors	M. ABRAHAM HARPSTER Co-Owner, Evergreen Farms, Inc.
BARBARA L. DORAN Portfolio Manager/Private Wealth Advisor Morgan Stanley	ADAM J. TALIAFERRO Healthcare Alliance Liaison Bristol Myers Squibb	BETSY E. HUBER Immediate Past Master, Pennsylvania State Grange
ANTHONY P. LUBRANO President, A.P. Lubrano & Company, Inc.		KEITH E. MASSER Chairman & Chief Executive Officer Sternman Masser, Incorporated
		CARL T. SHAFFER President Pennsylvania Farm Bureau
EMERITI TRUSTEES		
CYNTHIA A. BALDWIN Retired Justice Supreme Court of Pennsylvania	STEVE A. GARBAN Senior Vice President for Finance and Operations/Treasurer Emeritus The Pennsylvania State University	L. J. ROWELL, JR. Retired Chairman and Chief Executive Officer Provident Mutual Life Insurance
CHARLES C. BROSIUS Retired President Marlboro Mushrooms	DAVID R. JONES Retired Assistant Managing Editor The New York Times	CECILE M. SPRINGER President, Springer Associates
WALTER J. CONTI Retired Owner Cross Keys Inn/Pipersville Inn	EDWARD P. JUNKER III Retired Vice Chairman PNC Bank Corporation	HELEN D. WISE Former Deputy Chief of Staff for Programs and Secretary of the Cabinet Governor's Office
DONALD M. COOK, JR. Retired President SEMCOR, Incorporated	ROGER A. MADIGAN Retired State Senator 23rd Senatorial District	BOYD E. WOLFF Retired, Owner and Operator Wolfden Farms
MARIAN U. BARASH COPPERSMITH Retired Chairman of the Board The Barash Group	ROBERT D. METZGAR Former President North Penn Pipe & Supply, Incorporated	QUENTIN E. WOOD Retired Chairman of the Board and Chief Executive Officer Quaker State Corporation
ROBERT M. FREY Attorney-at-Law Frey & Tiley, P.C.	ANNE RILEY English Teacher	EDWARD P. ZEMPRELLI Attorney
	BARRY K. ROBINSON Attorney-at-Law	

**This publication is available in alternative media on request.**

The University is committed to equal access to programs, facilities, admission and employment for all persons. It is the policy of the University to maintain an environment free of harassment and free of discrimination against any person because of age, race, color, ancestry, national origin, religion, creed, service in the uniformed services (as defined in state and federal law), veteran status, sex, sexual orientation, marital or family status, pregnancy, pregnancy-related conditions, physical or mental disability, gender, perceived gender, gender identity, genetic information or political ideas. Discriminatory conduct and harassment, as well as sexual misconduct and relationship violence, violates the dignity of individuals, impedes the realization of the University's educational mission, and will not be tolerated. Direct all inquiries regarding the nondiscrimination policy to Dr. Kenneth Lehrman III, Vice Provost for Affirmative Action, Affirmative Action Office, The Pennsylvania State University, 328 Boucke Building, University Park, PA 16802-5901, Email: [kfl2@psu.edu](mailto:kfl2@psu.edu), Tel (814) 863-0471.

**ATTACHMENT B – Penn State University Self-Guarantee Agreement**

**The Pennsylvania State University  
Financial Assurance for Cost of Decommissioning Activities  
Self-Guarantee Agreement with the Nuclear Regulatory Commission**

**December 23, 2014**

(Source: NUREG-1757, Vol. 3, Rev 1, Appendix A, Section A.9.12)

Guarantee made by The Pennsylvania State University, a nonprofit university, organized under the laws of the Commonwealth of Pennsylvania, herein referred to as "guarantor," to the U. S. Nuclear Regulatory Commission, on behalf of the university as licensee.

The following licenses are covered under this guarantee:

License numbers:	R-2	Breazeale Nuclear Reactor	Docket 050-00005
	SNM-95	Penn State University	Docket 070-00113

Recitals

1. The guarantor has full authority and capacity to enter into this self-guarantee by the bylaws of the Trustees of the Pennsylvania State University.
2. This self-guarantee is being issued to comply with regulations issued by NRC, an agency of the U. S. Government, pursuant to the Atomic Energy Act of 1954, as amended, and the Energy Reorganization Act of 1974. NRC has promulgated regulations in Title 10, Chapter I of the *Code of Federal Regulations*, Parts 30, 50, and 70, which require that a holder of, or an applicant for, a materials license issued pursuant to 10 CFR Parts 30, 50, and 70 provide assurance that funds will be available when needed for required decommissioning activities.
3. The self-guarantee is issued to provide financial assurance for decommissioning activities for the licenses and facilities shown. The decommissioning costs for these activities are as follows:

<b>License # (Docket #)</b>	<b>License Description and Method</b>	<b>Certified Amounts or Current Cost Estimates 2014</b>
R-2 (050-00005)	Research Reactor 12/18/13 base estimate of \$16,031,304 plus 5% per year increase.	\$16,832,869
SNM-95 (070-00113)	Special Nuclear Material 12/18/13 base estimate of \$356,776 plus 5% per year increase.	\$374,615
	Sub total	\$17,207,484
	25% contingency fund	\$4,301,871
	<b>Total Estimated Costs:</b>	<b>\$21,509,355</b>

4. The guarantor meets or exceeds the following financial test criteria for a nonprofit university that issues bonds, and agrees to comply with all notification requirements as specified in 10 CFR 30 and 10 CFR 30 Appendix E.

Financial Test: The current rating for our most recent uninsured, uncollateralized, and unencumbered bond issuance is **AA** as issued by Standard & Poor's and **Aa2** as issued by Moody's.

5. The guarantor does not have a parent company holding majority control of its voting stock.
6. Decommissioning activities as used below refer to the activities required by 10 CFR Part 30, 50, and 70 for decommissioning of the facilities identified above.
7. Pursuant to the guarantor's authority to enter into this guarantee, the guarantor guarantees to the NRC that the guarantor shall:
  - (a) Carry out the required decommissioning activities, as required by the licenses listed above.
8. The guarantor agrees to submit revised financial statements, financial test data, and an auditor's special report and reconciling schedule annually within 180 days of the close of its fiscal year.
9. Not applicable.
10. The guarantor agrees that if, at the end of any fiscal year before termination of this self-guarantee, it fails to meet the self-guarantee financial test criteria, it shall send within 90 days of the end of the fiscal year, by certified mail, notice to the NRC that it intends to provide alternative financial assurance as specified in 10 CFR Part 30, 50, or 70. Within 120 days after the end of the fiscal year, the guarantor shall establish such financial assurance.
11. The guarantor also agrees to notify the NRC in writing in advance of any proposed change in or transfer of ownership of the licensed activity and to maintain this guarantee until the new licensee provides alternative financial assurance acceptable to the beneficiary.
12. The guarantor agrees that if it determines, at any time other than as described in Recital 10, that it no longer meets the self-guarantee financial test criteria or it is disallowed from continuing as a self-guarantor, it shall establish alternative financial assurance as specified in 10 CFR Parts 30, 50, or 70 within 30 days.
13. The guarantor, as well as its successors and assigns and agrees to remain bound jointly and severally under this guarantee notwithstanding any or all of the following: amendment or modification of the license or NRC-approved decommissioning funding plan for that facility, the extension or reduction of the time of performance of required activities, or any other modification or alteration of an obligation of the

licensee pursuant to 10 CFR Parts 30, 50, or 70.


14. The guarantor agrees that it shall be liable for all litigation costs incurred by the NRC in any successful effort to enforce the agreement against the guarantor. Such litigation costs shall not be deducted from or otherwise reduce the financial assurance provided by this guarantee.
15. The guarantor agrees to remain bound under this self-guarantee for as long as it, as licensee, must comply with the applicable financial assurance requirements of 10 CFR Part 30, 50, or 70, for the previously listed facilities, except that the guarantor may cancel this self-guarantee by sending notice by certified mail to the NRC, such cancellation to become effective not before an alternative financial assurance mechanism has been put in place by the guarantor.
16. The guarantor agrees that if it, as licensee, fails to provide alternative financial assurance as specified in 10 CFR Part 30, 50, or 70 and obtain written approval of such assurance from the NRC within 90 days after a notice of cancellation by the guarantor is received by the NRC from the guarantor, the guarantor shall make full payment under the self-guarantee.
17. The guarantor expressly waives notice of acceptance of this self-guarantee by the NRC. The guarantor also expressly waives notice of amendments or modifications of the decommissioning requirements.
18. If the guarantor files financial reports with the U.S. Securities and Exchange Commission, then it shall promptly submit them to its independent auditor and to NRC during each year in which this self guarantee is in effect.
19. The guarantor agrees that if the guarantor admits in writing its inability to pay its debts generally, or makes a general assignment for the benefit of creditors, or any proceeding is instituted by or against the guarantor seeking to adjudicate it as bankrupt or insolvent, or seeking dissolution, liquidation, winding-up, reorganization, arrangement, adjustment, protection, relief or composition of it or its debts under any law relating to bankruptcy, insolvency, or reorganization or relief of debtors, or seeking the entry of an order for relief or the appointment of a receiver, trustee, custodian, or other similar official for the guarantor or for any substantial part of its property, or the guarantor takes any action to authorize or effect any of the actions stated in this paragraph, then the Commission may:
  - (a) Declare that the financial assurance guaranteed by the guarantee agreement is immediately due and payable to the standby trust set up to protect the public health and safety and the environment, without diligence, presentment, demand, protest, or any other notice of any kind, all of which are expressly waived by guarantor; and

- (b) Exercise any and all of its other rights under applicable law.
20. The guarantor agrees to notify the NRC, in writing, immediately following the filing of a voluntary or involuntary petition for bankruptcy under any chapter of Title 11 (Bankruptcy) of the United States Code, or the occurrence of any other event listed in paragraph 19 of this guarantee and by or against the guarantor; the licensee; an entity (as that term is defined in 11 U.S.C. 101(14)) controlling the licensee or listing the license or licensees as property of the estate; or an affiliate (as that term is defined in 11 U.S.C. 101(2)) of the licensee. This notification must include: a description of the event, including major creditors, the amounts involved, and the actions taken to assure that the amount of funds guaranteed by the guarantee for decommissioning will be transferred to the standby trust as soon as possible; if a petition of bankruptcy was filed, the identity of the bankruptcy court in which the petition for bankruptcy was filed; and the date of filing of any petitions.
21. Not applicable.
22. The guarantor agrees that if, at any time before termination of this self-guarantee, its most recent bond issuance ceases to be rated in any category of "A-" and above by Standard and Poor's or in any category of "A3" and above by Moody's, the licensee will notify the Commission in writing within 20 days after publication of the change by the rating service.

I hereby certify that this self-guarantee is true and correct to the best of my knowledge.

Effective date: 12/23/14

Pennsylvania State University:



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

Signature of witness or notary: Donna A. Jones