PennState

Audited Financial Statements

The Pennsylvania State University
Fiscal Year Ended June 30, 2020

THE PENNSYLVANIA STATE UNIVERSITY

UNIVERSITY OFFICERS

as of November 4, 2020

ERIC J. BARRON
President

STEPHEN S. DUNHAM
Vice President and General Counsel

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

NICHOLAS P. JONES
Executive Vice President
and Provost

STEPHEN M. MASSINI
Chief Executive Officer, Penn State Health

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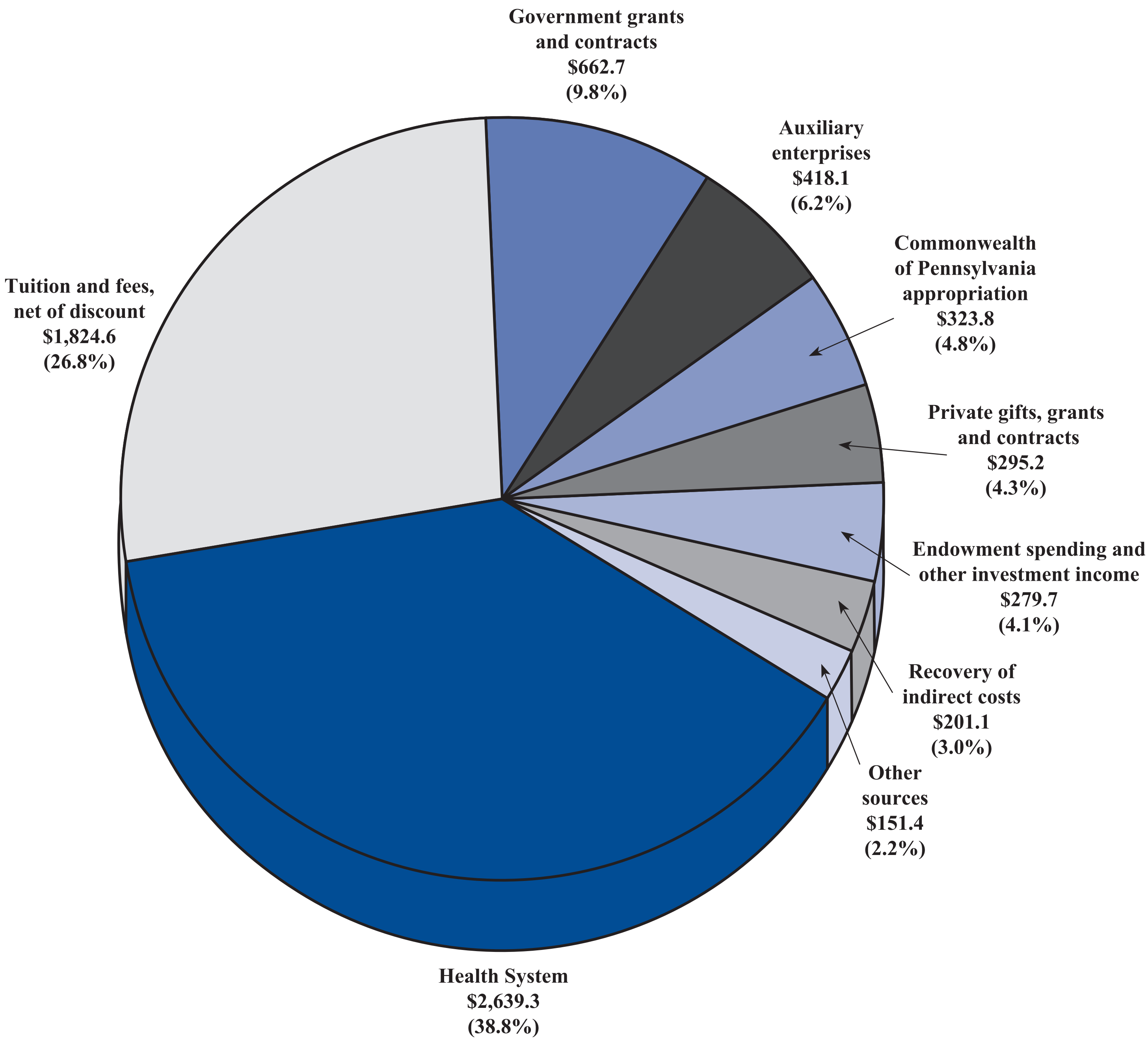
OPERATING REVENUES BY SOURCE ($6.8 billion)

For the Year Ended June 30, 2020

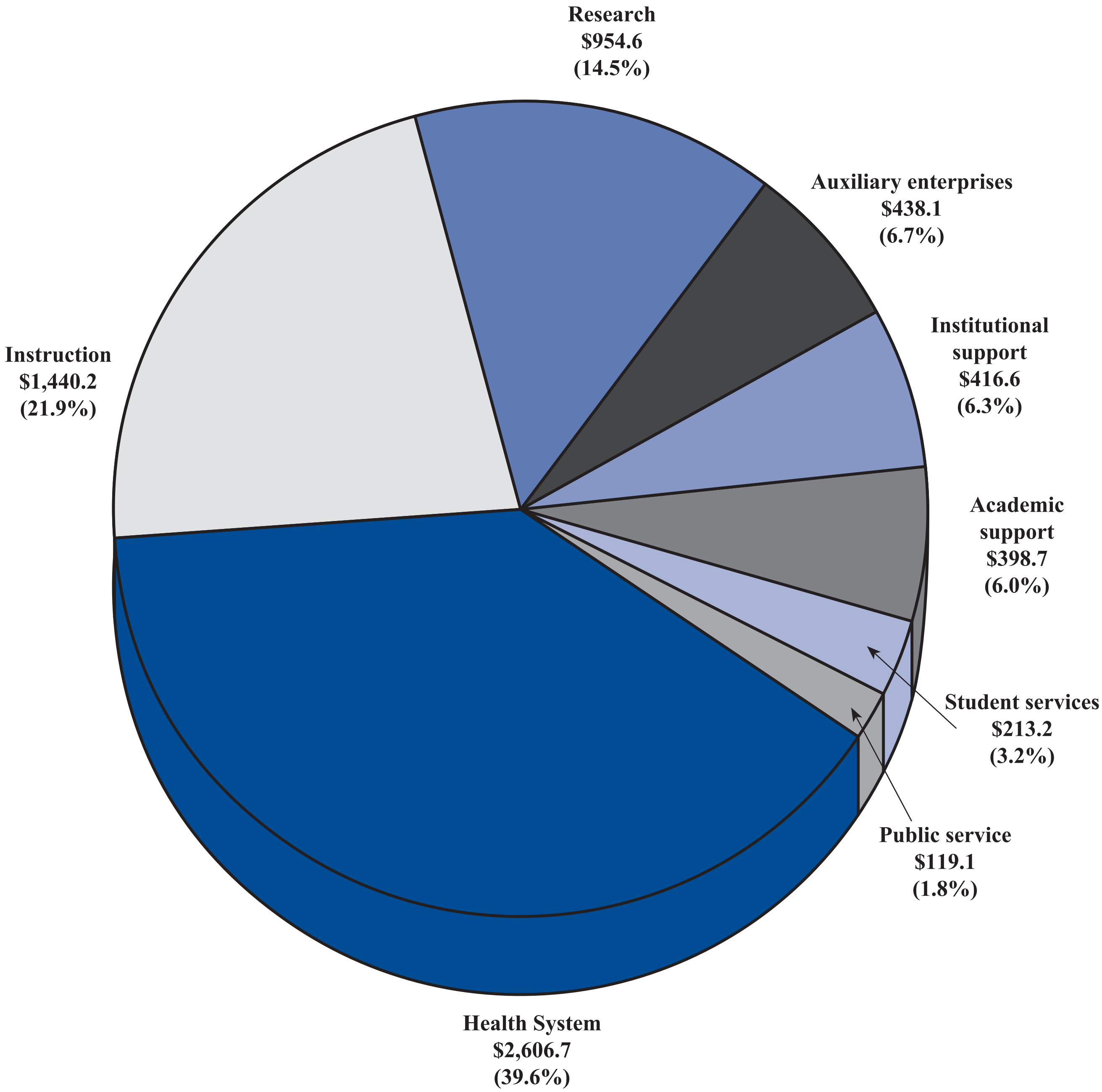
($ in millions)



OPERATING EXPENSES BY FUNCTION ($6.6 billion)

For the Year Ended June 30, 2020

($ in millions)



THE PENNSYLVANIA STATE UNIVERSITY

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VIRTUE LIBERTY AND INDEPENDENCE

PennState

Office of the Corporate Controller

The Pennsylvania State University
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University Park, PA 16802-1505
(814) 865-1355
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November 4, 2020

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

Dear Dr. Barron:

The audited consolidated financial statements of The Pennsylvania State University and subsidiaries (the "University") for the fiscal years ended June 30, 2020 and 2019 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

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

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

Deloitte.

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated financial statements of The Pennsylvania State University and its subsidiaries (the "University"), which comprise the consolidated statements of financial position as of June 30, 2020 and 2019, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the University as of June 30, 2020 and 2019, and the changes in its consolidated net assets and its consolidated cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

November 4, 2020

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
ASSETS
JUNE 30, 2020 AND 2019
(in thousands)

	June 30, 2020	June 30, 2019
Current assets:		
Cash and cash equivalents	$ 2,359,553	$ 2,178,713
Short-term investments	740,790	407,442
Deposits held by bond trustees	257,192	90,353
Deposits held for others	40,871	40,587
Accounts receivable, net of allowances	746,126	656,826
Contributions receivable, net	45,267	40,523
Loans to students, net of allowances	6,331	7,767
Inventories	58,927	52,516
Prepaid expenses and other assets	153,935	137,764
Total current assets	4,408,992	3,612,491
Noncurrent assets:		
Deposits held by bond trustees	18,800	28,400
Contributions receivable, net	163,320	139,007
Loans to students, net of allowances	42,431	46,329
Total investment in plant, net	5,974,192	5,588,943
Beneficial interest in perpetual trusts	24,509	23,898
Investments	6,610,518	6,304,490
Other assets	170,480	177,398
Total noncurrent assets	13,004,250	12,308,465
Total assets	$ 17,413,242	$15,920,956

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
LIABILITIES AND NET ASSETS
JUNE 30, 2020 AND 2019
(in thousands)

	June 30, 2020	June 30, 2019
Current liabilities:		
Accounts payable and other accrued expenses	$ 976,903	$ 728,510
Deferred revenue	343,127	364,875
Long-term debt	177,803	60,475
Present value of annuities payable	6,954	6,829
Accrued postretirement benefits	57,318	57,457
Total current liabilities	1,562,105	1,218,146
Noncurrent liabilities:		
Deposits held in custody for others	23,382	25,328
Deferred revenue	598	615
Long-term debt	3,336,205	1,590,177
Present value of annuities payable	49,610	50,220
Accrued postretirement benefits	2,287,496	2,166,578
Refundable United States Government student loans	40,019	47,309
Other liabilities	289,547	285,752
Total noncurrent liabilities	6,026,857	4,165,979
Total liabilities	7,588,962	5,384,125
Net assets:		
Without donor restrictions -		
Designated for specific purposes	3,121,070	4,108,982
Net investment in plant	3,619,773	3,543,893
Total without donor restrictions - The Pennsylvania State University	6,740,843	7,652,875
Noncontrolling interest	259,126	252,217
Total without donor restrictions	6,999,969	7,905,092
With donor restrictions	2,824,311	2,631,739
Total net assets	9,824,280	10,536,831
Total liabilities and net assets	$17,413,242	$15,920,956

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2020
(in thousands)

	Without Donor Restrictions	With Donor Restrictions	Total
Operating revenues and other support:			
Tuition and fees, net of discounts of $236,874	$ 1,824,603	$ -	$ 1,824,603
Commonwealth of Pennsylvania -			
Appropriations	323,792	-	323,792
Special contracts	77,450	-	77,450
Department of General Services projects	909	-	909
United States Government grants and contracts	584,406	-	584,406
Private grants and contracts	200,071	-	200,071
Gifts and pledges	73,558	21,611	95,169
Endowment spending	126,397	-	126,397
Other investment income	151,459	1,865	153,324
Sales and services of educational activities	111,328	-	111,328
Recovery of indirect costs	201,075	-	201,075
Auxiliary enterprises	418,111	-	418,111
Health System revenue	2,639,262	-	2,639,262
Other sources	40,051	-	40,051
Net assets released from restrictions	16,120	(16,120)	-
Total operating revenues and other support	6,788,592	7,356	6,795,948
Operating expenses:			
Educational and general -			
Instruction	1,440,195	-	1,440,195
Research	954,603	-	954,603
Public service	119,117	-	119,117
Academic support	398,719	-	398,719
Student services	213,140	-	213,140
Institutional support	416,602	-	416,602
Total educational and general	3,542,376	-	3,542,376
Auxiliary enterprises	438,058	-	438,058
Health System expense	2,606,724	-	2,606,724
Total operating expenses	6,587,158	-	6,587,158
Increase in net assets from operating activities	201,434	7,356	208,790
Nonoperating activities:			
Gifts and pledges	-	127,880	127,880
Current year investment returns	201,691	63,165	264,856
Endowment appreciation utilized	(109,697)	-	(109,697)
Changes in funds held by others in perpetuity	-	638	638
Write-offs and disposals of assets	(12,447)	-	(12,447)
Nonperiodic change in postretirement benefit plan	(52,422)	-	(52,422)
Other components of net periodic postretirement benefit cost	(79,591)	-	(79,591)
Actuarial adjustment on annuities payable	-	(6,467)	(6,467)
Pension prefunding expense	(1,061,000)	-	(1,061,000)
Increase (decrease) in net assets from nonoperating activities	(1,113,466)	185,216	(928,250)
Increase (decrease) in net assets - The Pennsylvania State University	(912,032)	192,572	(719,460)
Noncontrolling interest:			
Excess of revenues over expenses	6,909	-	6,909
Increase in net assets - noncontrolling interest	6,909	-	6,909
Increase (decrease) in total net assets	(905,123)	192,572	(712,551)
Net assets at the beginning of the year	7,905,092	2,631,739	10,536,831
Net assets at the end of the year	$ 6,999,969	$ 2,824,311	$ 9,824,280

See notes to consolidated financial statements.

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

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

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2020 AND 2019
(in thousands)

	June 30, 2020	June 30, 2019
Cash flows from operating activities:		
(Decrease) increase in net assets	$ (712,551)	$ 612,437
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities -		
Actuarial adjustment on annuities payable	6,467	4,661
Contributions restricted for long-term investment	(108,909)	(115,551)
Interest and dividends restricted for long-term investment	(39,747)	(75,444)
Net realized and unrealized gains on long-term investments	(359,645)	(366,667)
Depreciation expense	436,222	412,577
Amortization (gain) expense	(26)	1,171
Write-offs and disposals of assets	12,495	7,240
Contributions of land, buildings and equipment	(9,604)	(44,452)
Provision for bad debts	8,617	84,410
Increase in deposits held for others	(283)	(3,743)
Decrease (increase) in receivables	314	(137,644)
Increase in inventories	(6,411)	(3,794)
Increase in prepaid expenses and other assets	(3,877)	(22,077)
Increase in accounts payable and other accrued expenses	205,827	44,667
(Decrease) increase in deferred revenue	(21,778)	6,742
Increase in accrued postretirement benefits	120,780	30,479
Net cash (used in) provided by operating activities	(472,109)	435,012
Cash flows from investing activities:		
Purchase of land, buildings and equipment	(854,158)	(715,582)
Increase in deposits held by bond trustees	(157,239)	(16,094)
Repayments and advances on student loans	(10,190)	(3,059)
Collections on student loans	7,702	7,503
Purchase of investments	(4,517,307)	(2,886,333)
Proceeds from sale of investments	4,180,128	2,891,401
Net cash used in investing activities	(1,351,064)	(722,164)
Cash flows from financing activities:		
Contributions restricted for long-term investment	108,909	115,551
Interest and dividends restricted for long-term investment	39,747	75,444
Payments of annuity obligations	(7,947)	(6,858)
Proceeds from long-term debt	3,184,360	250,158
Principal payments on long-term debt	(1,322,158)	(58,369)
Proceeds related to government student loan funds, net of collection costs	1,102	834
Net cash provided by financing activities	2,004,013	376,760
Net increase in cash and cash equivalents	180,840	89,608
Cash and cash equivalents at the beginning of the year	2,178,713	2,089,105
Cash and cash equivalents at the end of the year	$ 2,359,553	$ 2,178,713

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, 2020 AND 2019

1. THE UNIVERSITY AND RELATED ENTITIES

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

Basis of Presentation

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

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

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

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

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

The University classifies its activities in the accompanying consolidated statements of activities as operating and nonoperating. Operating activities primarily include all income and expenses related to carrying out the University's educational, research, and outreach mission. Operating revenues also include contributions and investment return used to fund current operations.

Nonoperating activities include investment return, net of amounts designated for current operations; contributions and other resources to be retained in perpetuity; present value adjustments of annuities payable; gains or losses on disposal of property and equipment; nonperiodic changes and other components of postretirement benefits; and other activities considered to be of a more unusual or non-recurring nature.

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 investments, fair value measurements, postretirement benefits, and contingencies and commitments. Actual results could differ from those estimates.

Revenue Recognition

Tuition

Tuition revenue is recognized over the course of each semester (summer, fall, spring) as instruction is provided to students. Tuition is due from students by the beginning of each applicable semester. Overdue payments are reflected in accounts receivable as the University has an unconditional right to payment. Tuition included in deferred revenue reflects summer semester tuition collected prior to June 30, but applied to the subsequent fiscal year, as the University does not split summer semester revenue between fiscal years. Tuition receipts of $149.6 million, included in deferred revenue at June 30, 2019, were recognized during the year ended June 30, 2020. Tuition receipts of $147.5 million, included in deferred revenue at June 30, 2018, were recognized during the year ended June 30, 2019. Institutional financial aid provided by the University for tuition and fees is reflected as a reduction of tuition and fee revenue. As tuition contracts have a duration of one year or less, the University has elected to apply the optional exemption prescribed by ASC 606-10-50-14 and, as such, has not disclosed the aggregate transaction price allocated to unsatisfied performance obligations or the time at which the revenue associated with these unsatisfied performance obligations is expected to be recognized. At June 30, unsatisfied performance obligations under tuition contracts relate solely to summer semester instruction to be provided in July and August of the subsequent year. Transaction prices for tuition and fees are determined and allocated based on the applicable published tuition and fees schedules.

Grants and Contracts

Grants and contracts revenue is recognized over time as the eligible grant activities are conducted. Grants and contracts deemed to be exchange transactions fall under the scope of ASC Topic 606, Revenue from Contracts with Customers. The performance obligation for each grant or contract is deemed to be the research or program work itself. Work completed under grants and contracts does not result in assets that can be sold to other customers and the University is entitled to payment for the work completed to date. Grants and contracts that are deemed to be contributions fall under the scope of ASC Topic 958, Not-for-Profit Entities. These are deemed to be conditional contributions, as eligible expenditures must be incurred in order to have a right of release of funding from the sponsor. Most grants and contracts are cost reimbursement basis, and incurred expenditures are periodically billed to the customer for reimbursement. Grants and contracts receipts of $79.5 million, included in deferred revenue at June 30, 2019, were recognized during the year ended June 30, 2020. Grants and contracts receipts of $75.2 million, included in deferred revenue at June 30, 2018, were recognized during the year ended June 30, 2019. The University has entered into numerous grants and contracts, with periods of performance ending at various dates from July 1, 2020 through December 31, 2050. The estimated performance obligations remaining under these grants and contracts as of June 30, 2020 total $778.8 million. Transaction prices for grants and contracts are determined and allocated based on the budgets included in the respective award agreements.

Sales and Services of Educational Activities and Auxiliary Enterprises

Revenues from sales and services of educational activities and auxiliary enterprises consist primarily of health services, housing and food services, intercollegiate athletics, campus operations, and hospitality services. Performance obligations associated with these contracts consist of the provision of goods or services, and significant judgment is involved to determine whether the performance obligations are satisfied over time or at a point in time. Typically, revenue associated with semester-based contracts, such as housing and food services, is recognized over the course of the semester as services are provided. For other contracts, such as health services, athletic ticket sales, hotel room charges, and other campus operations, revenue is recognized at a point in time, when the good or service is provided. Contracts included in sales and services of educational activities and auxiliary enterprises are typically one year or less in length. As such, receipts included in deferred revenue at June 30, 2019 and 2018 were recognized during the years ended June 30, 2020 and 2019, respectively. In addition, the University has elected to apply the optional exemption prescribed by ASC 606-10-50-14 and, as such, has not disclosed the aggregate transaction price allocated to unsatisfied performance obligations or the time at which the revenue associated with these unsatisfied performance obligations is expected to be recognized. At June 30, unsatisfied performance obligations under sales and services of educational activities and auxiliary enterprises relate primarily to summer semester housing and food services to be provided in July and August of the subsequent year, as well as athletic events held during the fall semester. Transaction prices for sales and services of educational activities and auxiliary enterprises are typically straightforward and explicitly stated in the contract.

Health System

The Health System reports net patient service revenue at the amounts that reflect the consideration to which the Health System expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including managed care and government programs) and others, and they include explicit and implicit price concessions, as well as variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, the Health System bills patients and third-party payors several days after the services are performed or shortly after discharge. Revenues are recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by the Health System. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. The Health System believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the Health System receiving inpatient acute care services. The Health System measures the performance obligation from admission into the Health System to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided, and the Health System does not believe it is required to provide additional goods or services to the patient.

Because all of its performance obligations relate to contracts with a duration of less than one year, the Health System has elected to apply the optional exemption provided in ASC 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

The Health System has elected the practical expedient provided by ASC 340-40-25-4 and all incremental customer contract acquisition costs are expensed as they are incurred, as the amortization period of the asset that the Health System otherwise would have recognized is one year or less in duration.

The Health System utilizes the portfolio approach practical expedient in ASC 606 for contracts related to net patient service revenue. The Health System accounts for contracts within each portfolio as a collective group, rather than individual contracts, based on the payment pattern expected in each portfolio category and the similar nature and characteristics of the patients within each portfolio. As a result, the Health System has concluded that revenue for a given portfolio would not be materially different than if accounting for revenue on a contract by contract basis.

Generally, patients who are covered by third party payors are responsible for patient responsibility balances, including deductibles and coinsurance, which vary in amount. The Health System estimates the transaction price for patients with deductibles and coinsurance based on historical experience and current market conditions. The initial estimate of the transactions price is determined by reducing the standard charge by any contractual amounts, discounts, and implicit price concessions (routine uncollectible amounts). Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Adjustments arising from a change in transaction price were not significant in 2019.

The Health System has agreements with third party payors that provide for payments at amounts different from its established charges. Inpatient acute care services rendered are paid at prospectively determined rates per discharge in accordance with the Federal Prospective Payment System (PPS) for Medicare and generally at negotiated or otherwise predetermined amounts. Inpatient, nonacute, and outpatient services are paid at various rates under different arrangements with third party payors, commercial insurance carriers, and health maintenance organizations. The basis for payment under these agreements includes prospectively determined discounts from the Health System's established charges, fee schedules, and per diem rates for certain services.

Law and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. During 2020 and 2019, a decrease of $2.1 million and $3.0 million was recognized reflecting the difference in actual versus estimated reimbursement and the change in certain estimates related to prior years' patient service revenue.

The subsidiaries of the Health System provide care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. The Health System does not pursue collection of amounts determined to qualify as charity care; these amounts are not reported as net patient service revenue. The amounts of direct and indirect costs for services and supplies furnished under the Health System's charity care policy totaled approximately $36.0 million and $30.4 million for the years ended June 30, 2020 and 2019, respectively, and is based on a ratio of the Health System's operational costs to its gross charges. The amount of charges foregone for services and supplies furnished under the Health System's charity policy totaled approximately $76.6 million and $60.4 million during 2020 and 2019, respectively.

Overall

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

<u>Contributions</u>

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

<u>Fair Value of Financial Instruments</u>

The University has provided fair value estimates for certain financial instruments. Fair value information presented in the financial statements is based on information available at June 30, 2020 and 2019. 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, 2020 and 2019 have been made at the rates available to students for similar loans at such times. Investments are reported at fair value as disclosed in Note 4. The fair value of the University's bonds payable is disclosed in Note 8. See Note 6 for further discussion of fair value measurements.

Cash Flows

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

(in thousands of dollars)		2020		2019
Interest paid	$	72,817	$	59,135
Non-cash acquisitions of land, buildings and equipment		10,980		53,425

Capitalized costs accrued related to construction are $34.1 million and $76.2 million as of June 30, 2020 and 2019, respectively. Taxes paid for 2020 and 2019 are considered immaterial. Cash and cash equivalents include certain investments in highly liquid instruments with initial maturities of 90 days or less, except for such assets held by the University's investment managers as part of their long-term investment strategies. Short-term investments include other current investments held for general operating purposes with maturities greater than 3 months but less than 12 months.

Accounts Receivable

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

(in thousands of dollars)		2020		2019
Grants and contracts, net of allowance of $2,173 and $2,105	$	177,086	$	163,761
Patient accounts receivable, net of allowance of $91,899 at June 30, 2019		306,120		348,331
Student receivables, net of allowance of $14,706 and $15,467		45,169		50,978
Investment and interest receivable		153,441		25,520
Other, net of allowance of $7,515 and $7,299		64,310		68,236
Total accounts receivable, net	$	746,126	$	656,826

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.

For patient accounts receivable at June 30, 2019, the balance reflects an allowance for doubtful accounts that was based on management's analysis of contractually due amounts associated with services provided to patients who have third-party coverage (for example, for expected uncollectible deductibles and copayments or for payors who were known to be having financial difficulties that made the realization of amounts due unlikely). For receivables from self-pay patients at June 30, 2019, the subsidiaries of the Health System recorded a provision for bad debts in the period of service on the basis of past experience, which indicated that many patients were unable or unwilling to pay the portion of their bill for which they were financially responsible. In estimating the allowance for doubtful accounts, account age was 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 had been exhausted was charged off against the allowance for doubtful accounts. For patient accounts receivable at June 30, 2020, no allowance is reflected due to the adoption of ASC Topic 606.

Loans to Students

Loans to students are disbursed to qualified students based on need and include loans granted by the University from institutional resources and under federal government loan programs. Students enter a grace period upon ceasing at least half-time enrollment status. The grace period varies depending on the type of loan. Upon expiration of the grace period, interest begins to accrue, and repayment begins one month thereafter. Repayments of these loans are made directly to the University. Loans to students are uncollateralized and carry default risk. At June 30, 2020 and 2019, student loans represent 0.3% and 0.3% of total assets, respectively.

Funds advanced by the federal government of $40.0 million and $47.3 million at June 30, 2020 and 2019, respectively, are ultimately refundable to the government and are classified as liabilities in the consolidated statements of financial position. The University is liquidating its Perkins portfolio through collections of outstanding Perkins loans. The federal liability related to the Perkins loan program will be reduced through the return of funds as required by the Department of Education.

Loans to students consisted of the following at June 30:

(in thousands of dollars)	2020	2019
Loans to students:		
Federal government loan programs:		
Perkins loan program	$ 31,410	$ 37,053
Health Professions Student Loans and Loans for Disadvantaged Students	4	11
Federal government loan programs	31,414	37,064
Institutional loan programs	20,412	20,726
	51,826	57,790
Less allowance for doubtful accounts:		
Balance, beginning of year	(3,694)	(3,443)
Provision for doubtful accounts	630	(251)
Balance, end of year	(3,064)	(3,694)
Loans to students, net	$ 48,762	$ 54,096

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

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

(in thousands of dollars)

2020	45 days or less	46-75 days	76-105 days	Over 105 days	Total
Loans to students:					
Federal government loan programs	$ 25,833	$ 32	$ 34	$ 5,515	$ 31,414
Institutional loan programs	17,245	20	21	3,126	20,412
Total loans to students	43,078	52	55	8,641	51,826
Allowance for doubtful accounts:					
Federal government loan programs					(436)
Institutional loan programs					(2,628)
Total allowance for doubtful accounts					(3,064)
Total loans to students, net					$ 48,762

(in thousands of dollars)

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

Inventories

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

Investments

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

The estimated fair value amounts for marketable debt, equity and fixed income securities held by the University have been determined using available market information as supplied by the various financial institutions that act as trustees or custodians for the University. For non-liquid holdings, generally limited partnership investments in private real estate, venture capital, private equity, natural resources, and private debt, estimated fair value is determined based upon financial information provided by the general partner. This financial information includes assumptions and methods that were reviewed by University management. The University believes that the estimated fair value is a reasonable estimate of market value as of June 30, 2020 and 2019. Because the limited partnerships are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market existed, and such differences could be material.

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

Beneficial Interest in Perpetual Trusts

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

Investment in Plant

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

(in thousands of dollars)	2020	2019
Land	$ 167,894	$ 157,852
Buildings	8,287,052	7,744,942
Improvements other than buildings	778,983	722,140
Equipment	1,861,050	1,750,893
Total plant	11,094,979	10,375,827
Less accumulated depreciation	(5,120,787)	(4,786,884)
Total investment in plant, net	$ 5,974,192	$ 5,588,943

The value of land, buildings, and equipment is recorded at cost or, if received as gifts, at fair value at date of gift commitment. The University does not capitalize the cost of library books. Depreciation is computed over the estimated useful lives of the assets using the straight-line method. Useful lives range from 4 to 50 years for buildings, 10 to 20 years for improvements other than buildings, and 1 to 20 years for equipment. Depreciation expense was $436.2 million and $412.6 million for the fiscal years ended June 30, 2020 and 2019, respectively. The University has certain building and equipment lease agreements in effect which are considered capital leases that are included as long-term debt in the statements of financial position. These leases have been capitalized at the lower of fair market value or net present value of the minimum lease payments. Buildings and equipment held under capital leases are amortized on a straight-line basis over the shorter of the lease terms or the estimated useful lives of the assets. The capitalized cost and accumulated depreciation of the leases at June 30, 2020 and 2019 were $121.4 million and $72.4 million, and $130.9 million and $71.5 million, respectively.

Accounts Payable and Other Accrued Expenses

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

(in thousands of dollars)	2020	2019
Accounts payable (non-Health System)	$ 274,635	$ 270,540
Health System accounts payable and other accrued expenses	372,786	323,729
Health System Medicare APP	160,320	-
Accrued payroll and other related liabilities	139,604	113,249
Accrued bond interest	25,696	17,865
Student deposits	3,862	3,127
Total accounts payable and other accrued expenses	$ 976,903	$ 728,510

Impairment of Long-Lived Assets

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

Asset Retirement Obligations

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

	(in thousands of dollars)
Balance as of June 30, 2018	$ 81,231
Adjustment to liability	8,540
Accretion expense	3,516
Liabilities settled	(10,121)
Balance as of June 30, 2019	83,166
Adjustment to liability	12,750
Accretion expense	3,681
Liabilities settled	(4,167)
Balance as of June 30, 2020	$ 95,430

Annuities Payable

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

Net Assets

Net assets consist of the following at June 30:

(in thousands of dollars)	2020	2019
Net assets without donor restrictions:		
Designated for specific purposes:		
Designated for plant activities	$ 1,591,041	$ 1,501,045
Health System	1,334,644	1,306,953
Operating budget carryforward	1,136,335	1,053,237
Funds functioning as endowments	922,800	860,795
Designated for scholarships	118,600	112,687
Designated for pension prefunding	(1,061,000)	-
Designated for postretirement benefits	(1,063,060)	(961,864)
Other designated net assets	141,710	236,129
Total designated for specific purposes	3,121,070	4,108,982
Net investment in plant	3,619,773	3,543,893
Non-controlling interest	259,126	252,217
Total net assets without donor restrictions	$ 6,999,969	$ 7,905,092
Net assets with donor restrictions:		
Endowment funds	$ 2,454,544	$ 2,307,883
Future contributions	228,031	200,794
Split-interest agreements	94,537	92,919
Student loan funds	18,471	17,391
Contributions for property, plant and equipment	28,728	12,752
Total net assets with donor restrictions	$ 2,824,311	$ 2,631,739
Total net assets	$ 9,824,280	$ 10,536,831

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

Income Taxes

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

Recent Accounting Pronouncements

In February 2016, the FASB issued Accounting Standards Update ("ASU") 2016-02, *"Leases."* This update requires substantial changes to lease accounting to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The main difference between previous GAAP and this guidance is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating under previous GAAP. In June 2020, the FASB issued ASU 2020-05, *"Revenue from Contracts with Customers and Leases; Effective Dates for Certain Entities."* This update defers the effective date of the original ASU. The update is now effective for the University beginning July 1, 2020. The University is currently evaluating the impact this guidance may have on its consolidated financial statements.

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

In January 2020, the FASB issued ASU 2020-01, *"Investments – Equity Securities (Topic 321), Investments – Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815); Clarifying the Interactions between Topic 321, Topic 323, and Topic 815."* This update clarifies the interaction of the accounting for equity securities under Topic 321 and investments accounted for under the equity method of accounting in Topic 323 and the accounting for certain forward contracts and purchased options accounted for under Topic 815. This update is effective for the University beginning July 1, 2022 with early adoption permitted. The University is currently evaluating the impact this guidance may have on its consolidated financial statements.

In September 2020, the FASB issued ASU 2020-07, *"Not-for-Profit Entities; Presentation and Disclosure by Not-for-Profit Entities for Contributed Nonfinancial Assets."* This update requires a not-for-profit entity to present contributed nonfinancial assets as a separate line item in the statement of activities, apart from contributions of cash and other financial assets. In addition, not-for-profit entities are required to disclose additional qualitative and quantitative information related to nonfinancial assets. This update is effective for the University beginning July 1, 2021 with early adoption permitted. The University is currently evaluating the impact this guidance may have on its consolidated financial statements.

Coronavirus Pandemic

In March 2020, the World Health Organization declared the novel coronavirus ("COVID-19") a pandemic. The outbreak of the disease has affected travel, commerce and financial markets globally, including in the United States. The continued spread of COVID-19 and its impact on social interaction, travel, economies and financial markets may adversely affect operations and financial condition, including, among other things, (i) the ability of the University to conduct its operations and/or the cost of operations, (ii) governmental and non-governmental funding, and (iii) financial markets impacting investments valuation and interest rates.

Beginning in March 2020, undergraduate and graduate course instruction was conducted virtually, and most students vacated the campus. The University granted refunds of $52.5 million in fiscal year 2020 for housing and dining services not provided after the move to virtual learning. Students continued to meet their academic requirements for the remainder of the 2019-20 academic year. In addition, the start of the 2020-21 academic year will be a hybrid learning environment, with a mix of virtual and in-person learning. Given the uncertainty over the progression of the virus and governmental emergency directives, there is no timetable for when instruction and campus operations will return to normal.

The Health System also experienced a significant reduction in the number of surgeries, physician office visits and emergency room volumes. This was due to measures meant to slow the spread of the virus, including quarantines and stay-at-home and shelter-in-place orders, as well as the community's general concerns related to the risk of contracting COVID-19.

The federal government has taken several actions to provide financial assistance during this pandemic. The University has received, and may continue to receive, payments and advances under the Coronavirus Aid, Relief, and Economic Security Act, as amended by the Paycheck Protection Program and Health Care Enhancement Act (collectively, the "CARES Act") or any other governmental assistance program which will be beneficial in addressing the impact of the novel coronavirus pandemic on the University's results of operations and financial position. The CARES Act, which was signed into law on March 27, 2020, provides funding and flexibilities for higher education institutions to respond to the COVID-19 emergency. The University received an allocation of $55.0 million based on the allocation criteria. At least 50% of these funds must be distributed as emergency aid to students who have had their semester disrupted by the COVID-19 pandemic with the remaining 50% of funds able to be used for institutional uses. The CARES Act defines allowable uses as any costs associated with significant changes to the delivery of instruction due to the coronavirus. At June 30, 2020, the University has disbursed $24.2 million of the available $27.5 million of the student portion of the funds. This disbursement of funds is presented within the instruction expense line within the consolidated statements of activities. At June 30, 2020, the University has recorded a receivable of $0.9 million for funds disbursed to students but not yet reimbursed. At June 30, 2020 the University has not recorded any revenue or receivable related to the institutional portion of the CARES Act funding. As allowed by the CARES Act, at June 30, 2020, the University has deferred payment of $24.9 million for the employer portion of Social

Security payroll tax, which is included in accounts payable and other accrued expenses in the consolidated statements of financial position. 50% of the deferred tax credit must be paid by December 31, 2021 with the remainder by December 31, 2022. The CARES Act also revised the Medicare accelerated payment program ("Medicare APP"). For the year ended June 30, 2020, the Health System received approximately $160.3 million of Medicare APP funding under this program which is recorded as accounts payable and other accrued expenses in the consolidated statements of financial position. Also, during the year ended June 30, 2020, the Health System received approximately $62.3 million from the Public Health and Social Services Emergency Fund ("Provider Relief Fund") of which $53.1 million has been recognized in Health System revenue within the consolidated statement of activities. Providers who have been allocated a Provider Relief Fund payment must sign an attestation confirming receipt of the funds and agreeing to certain terms and conditions of payment. For the amounts not recognized of $9.1 million, the Health System is investigating if the funds will be able to be retained and are recorded as accounts payable and other accrued expenses in the consolidated statements of financial position.

In September 2020, Health and Human Services (HHS) issued new guidance on the reporting and recognition requirements for Provider Relief Fund recipients. The new guidance is not expected to have a material impact on the amounts recognized as Health System revenue in the consolidated statements of activities.

The COVID-19 pandemic has negatively affected national, state, and local economies and global financial markets, and the higher education landscape in general. While the financial impact on the University cannot be quantified at this time, the pandemic may have a material adverse effect on the current and future financial profile and operating performance of the University. The University continues to monitor the course of the pandemic and is prepared to take additional measures to protect the health of the University community and promote the continuity of its academic mission.

3. LIQUIDITY AND AVAILABILITY OF FINANCIAL ASSETS

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

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

In addition to financial assets available to meet general expenditures over the next 12 months, the University operates with a balanced budget and anticipates collecting sufficient revenue to cover general expenditures not covered by donor-restricted resources.

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

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

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

(in thousands of dollars)	June 30, 2020	June 30, 2019
Total assets	$ 17,413,242	$ 15,920,956
Less:		
Inventories	(58,927)	(52,516)
Prepaid expenses and other assets	(153,935)	(137,764)
Total investment in plant, net	(5,974,192)	(5,588,943)
Beneficial interest in perpetual trusts	(24,509)	(23,898)
Other assets	(170,480)	(177,398)
Total financial assets	11,031,199	9,940,437
Less:		
Noncurrent investments	(6,610,518)	(6,304,490)
Contractual or donor-imposed restrictions:		
Deposits held by bond trustees	(275,992)	(118,753)
Deposits held for others	(40,871)	(40,587)
Receivables subject to time restrictions	(47,633)	(58,071)
Receivables subject to donor-imposed restrictions	(141,006)	(102,791)
Loans to students, net	(48,762)	(54,096)
Financial assets available to meet cash needs for general expenditures within one year	$ 3,866,417	$ 3,261,649

4. INVESTMENTS

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

(in thousands of dollars)	2020	2019
Money markets	$ 268,874	$ 318,849
Fixed income:		
U.S. government/agency	828,467	941,173
U.S. corporate	617,598	594,125
Foreign	181,614	148,584
Other	830,794	451,674
Equities	2,472,967	2,198,001
Private capital	2,150,994	2,059,526
Total	$ 7,351,308	$ 6,711,932

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

Futures contracts comprise the University's beneficially held derivative instruments at June 30, 2020 and 2019 and are included in the fair value of the University's investments. These contracts are fully cash collateralized and marked to market daily. The fair value of derivative instruments is included in the fair value of the University's investments within the money market category. Futures contracts have minimal credit risk because the counterparties are the exchanges themselves. Fully cash collateralized derivative securities comprised $4.4 million or 0.06% and $4.0 million, or 0.06%, of total investments at June 30, 2020 and 2019, respectively. The University's derivatives consist of S&P equity futures at June 30, 2020 and 2019 and are employed as a low cost, passive investment vehicle with daily liquidity which allows the University to maintain desired market exposure in light of irregular cash flows.

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

(in thousands of dollars) 2020	Without donor restrictions	With donor restrictions	Total
Investment income	$ 168,159	$ 14,626	$ 182,785
Net realized gains, including endowment spending	167,949	35,934	203,883
Net unrealized gains	33,742	14,470	48,212
Total returns	$ 369,850	$ 65,030	$ 434,880

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

5. ENDOWMENT NET ASSETS

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

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

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

From time to time, due to unfavorable market fluctuations, the fair value of some assets associated with individual donor-restricted endowment funds may fall below the level that donors require to be retained as a perpetual fund, while other assets are unaffected to the same extent and maintain or exceed the level required. Such deficiencies are reported as net assets with donor restrictions. As of June 30, 2020 and 2019, funds with an original gift value of $44.8 million and $13.0 million were "underwater" by $3.0 million and $2.3 million, respectively. Subsequent investment gains will be used to restore the balance up to the fair market value of the original gift.

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

(in thousands of dollars) 2020	Without donor restrictions	With donor restrictions	Total
Donor-restricted endowment funds	$ -	$ 2,424,281	$ 2,424,281
Funds functioning as Endowments	922,801	-	922,801
Total net assets	$ 922,801	$ 2,424,281	$ 3,347,082

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

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

(in thousands of dollars) 2020	Without donor restrictions	With donor restrictions	Total
Endowment net assets, beginning of the year	$ 860,795	$ 2,278,892	$ 3,139,687
Endowment return, net	147,873	59,716	207,589
Contributions	-	85,673	85,673
Endowment spending	(126,397)	-	(126,397)
Transfers to create funds functioning as endowments	40,530	-	40,530
Endowment net assets, end of the year	$ 922,801	$ 2,424,281	$ 3,347,082

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

Not included above are the endowment net assets of subsidiaries of $33.7 million and $32.4 million as of June 30, 2020 and 2019, respectively.

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

To satisfy its long-term rate-of-return objectives, the University relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The University targets diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints. The endowment assets of the University are invested in a broad range of equities and fixed income securities, thereby limiting the market risk exposure in any one institution or individual investment.

The University has a policy of appropriating for distribution each year a certain percentage (4.5% for 2020 and 2019) of its pooled endowment fund's average fair market value over the prior five years preceding the fiscal year in which the distribution is planned. Accordingly, over the long term, the University expects the current spending policy to allow its endowment to provide generous current spending while preserving "intergenerational equity". This is consistent with the University's objective to maintain the purchasing power of the endowment assets held in perpetuity as well as to provide additional real growth through new gifts and investment returns.

6. FAIR VALUE MEASUREMENTS

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

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

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

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

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

The following table presents information as of June 30, 2020 about the University's financial assets and liabilities that are measured at fair value on a recurring basis:

(in thousands of dollars)	Quoted Prices in Active Markets For Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total Fair Value
Assets:				
Long-term Investment Pool:				
Money markets	$ 225,684	$ 13,742	$ -	$ 239,426
Fixed income				
U.S. government/agency	-	78,157	-	78,157
U.S. corporate	-	44,134	-	44,134
Foreign	-	7,748	-	7,748
Other	-	211,245	-	211,245
Equities	785,810	325	-	786,135
Total	$ 1,011,494	$ 355,351	$ -	$ 1,366,845
Operating investments:				
Money markets	$ 29,448	$ -	$ -	$ 29,448
Fixed income				
U.S. government/agency	2,573	747,737	-	750,310
U.S. corporate	11,368	562,096	-	573,464
Foreign	162	173,704	-	173,866
Other	152,364	467,185	-	619,549
Equities	245,315	54,613	5,132	305,060
Total	$ 441,230	$ 2,005,335	$ 5,132	$ 2,451,697
Deposits held by bond trustees:				
Money markets	$ 275,992	$ -	$ -	$ 275,992
Beneficial interest in perpetual trusts	$ -	$ -	$ 24,509	$ 24,509
Liabilities:				
Present value of annuities payable	$ -	$ -	$ 56,564	$ 56,564

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

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

The fair value tables above exclude investments of $3,532.8 million and $3,132.6 million as of June 30, 2020 and 2019, respectively, which are measured at net asset value (NAV) per share or its equivalent and are not classified in the fair value hierarchy.

The Long-term Investment Pool (LTIP) is a mutual fund-like vehicle used for investing the University's endowment funds, funds functioning as endowments, and other operating funds that are expected to be held long-term. A share method of accounting for the LTIP is utilized by the University. Each participating fund enters into and withdraws from the LTIP based on monthly share values. At June 30, 2020 and 2019, the fair value of endowment funds and funds functioning as endowments within the LTIP totaled $3,351.2 million and $3,164.9 million, respectively. At June 30, 2020 and 2019, the fair value of operating funds included in the LTIP totaled $1,399.8 million and $1,383.5 million, respectively.

The following tables present information related to changes in Level 3 for each category of financial assets and liabilities for year ended June 30, 2020:

(in thousands of dollars)	Operating Investments	Long Term Investment Pool	Beneficial Interest in Perpetual Trusts
Assets:			
Beginning balance	$ 5,624	$ 40	$ 23,898
Total realized and unrealized gains (losses)	(331)	-	611
Net transfers out	(161)	(40)	-
Ending balance	$ 5,132	$ -	$ 24,509

	Present Value of Annuities Payable
Liabilities:	
Beginning balance	$ 57,049
Actuarial adjustment of liability	(548)
Gifts	719
Sales	(656)
Ending balance	$ 56,564

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

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

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

There were no transfers of assets between Level 3 and Level 2 in 2019 and between Level 1 and Level 2 in 2020 and 2019.

The following table presents the fair value and redemption frequency for those investments whose fair value is not readily determinable and is estimated using NAV or its equivalent as of June 30, 2020 and 2019:

(in thousands of dollars)	Fair Value 2020	Fair Value 2019	Unfunded Commitments At June 30, 2020	Redemption Frequency	Redemption Notice Period
Commingled Funds:					
U.S. Equity	$ 347,000	$ 262,664		Monthly	30 days
Non-U.S. Equity	701,902	693,701		Daily/Monthly Quarterly	5-90 days
Subtotal	$ 1,048,902	$ 956,365			
Marketable Investment Partnerships:					
Absolute Return	$ 98,031	$ 61,895		Quarterly	60 days
Distressed Debt	51,611	54,518		Quarterly/ Semi Annual	60-90 days
Commodities	55,429	70,711		Monthly	30-60 days
Opportunistic	439,617	291,267		Monthly/ Quarterly/ Annually	30-90 days
Directional Long/Short	317,408	288,072		Monthly	30 days
Core Real Estate	25,109	-		Quarterly	90 days
Subtotal	$ 987,205	$ 766,463			
Non-Marketable Investment Partnerships:					
Private Real Estate	$ 64,303	$ 56,782	$ 69,930		
Venture Capital	600,905	530,760	165,380		
Private Equity	479,269	500,739	330,195		
Natural Resources	123,414	133,764	70,111		
Private Debt	228,768	187,733	197,993		
Subtotal	$ 1,496,659	$ 1,409,778	$ 833,609		
Total	$ 3,532,766	$ 3,132,606	$ 833,609		

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

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

Non-Marketable Investment Partnerships include limited partnership interests in a variety of illiquid investments. The fair values of the investments for each fund in this category have been estimated using the net asset value of the LTIP's ownership interest in partner's capital and cannot be redeemed. Realizations from each fund are received as the underlying investments are liquidated or distributed, typically within 10 years after initial commitment. Unfunded commitments represent remaining commitments of the LTIP's drawdown funds as of June 30, 2020. Five major investment strategies are included within this category. Private Real Estate includes properties primarily located in the U.S. Venture Capital includes non-public startups and enterprises in early stages of growth located globally. Private Equity includes buyouts of previously public companies as well as enterprises that are planning to go public in the near future, including funds focusing on opportunities outside the U.S. Natural Resources largely include companies primarily involved in oil and natural gas in addition to a variety of other natural resources. Private Debt includes global private credit securities rated below investment grade as well as non-rated debt.

7. CONTRIBUTIONS RECEIVABLE

Contributions receivable are summarized as follows as of June 30:

(in thousands of dollars)	2020	2019
In one year or less	$ 48,794	$ 47,135
Between one year and five years	87,164	75,687
More than five years	122,935	112,164
Contributions receivable, gross	258,893	234,986
Less allowance	(3,825)	(5,723)
Less discount	(46,481)	(49,733)
Contributions receivable, net	$ 208,587	$ 179,530

Contributions received during the years ended June 30, 2020 and 2019 are discounted at rates ranging from 0.16% to 0.19% and 1.71% to 2.15%, respectively. The discount rates for prior periods ranged from 0.11% to 6.28%.

At June 30, 2020 and 2019, the University has received bequest intentions of $682.6 million and $606.3 million, respectively, and certain other conditional promises to give of $53.1 million and $50.5 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, 2020:

	(in thousands of dollars)
Balance at the beginning of year	$ 179,530
New pledges	79,435
Collections on pledges	(55,527)
Decrease in allowance	1,898
Decrease in unamortized discounts	3,251
Balance at the end of year	$ 208,587

In preparing the 2019 financial statements, the University identified and corrected an out of period error related to certain conditional contributions that had been previously recognized as unconditional contributions. As such, contributions receivable in the accompanying consolidated statement of financial position as of June 30, 2019, and gifts and pledges with donor restrictions in the accompanying consolidated statement of activities for the year ended June 30, 2019 have been reduced by $27.6 million, respectively, to correct this out of period error.

8. LONG-TERM DEBT

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

(in thousands of dollars)	2020	2019
The Pennsylvania State University Bonds		
Series 2020A	$ 80,495	$ -
Series 2020B	331,040	-
Series 2020D	1,065,165	-
Series 2020E	61,885	-
Series 2019A	107,000	107,000
Series 2019B	119,000	119,000
Series 2018	63,235	64,210
Series 2017A	152,170	154,680
Series 2017B	119,645	122,340
Series 2016A	114,070	116,890
Series 2016B	201,805	211,980
Series 2015A	59,220	60,800
Series 2015B	96,540	100,515
Series 2010	-	123,625
Series 2009B	-	74,235
Series 2007B	39,925	43,835
Pennsylvania Higher Educational Facilities Authority University Revenue Bonds (issued for The Pennsylvania State University)		
Series 2006	1,890	2,155
Series 2004	1,905	2,230
Series 2002	1,045	1,530
Penn State Health Bonds		
Series 2019	200,000	-
Cumberland County Municipal Authority Revenue Bonds (issued for Penn State Health)		
Series 2019	222,000	-
Lycoming County Authority College Revenue Bonds (issued for Penn College)		
Series 2016	48,820	50,675
Series 2015	2,875	3,440
Series 2012	21,005	22,175
Series 2011	36,315	37,655
Total bonds payable	3,147,050	1,418,970
Unamortized bond premiums	208,372	164,003
Unamortized deferred bond costs	(14,164)	(6,504)

Notes payable, lines of credit and capital leases		
Notes payable	24,688	21,366
Lines of credit	105,000	-
Capital lease obligations	43,062	52,817
Total notes payable, lines of credit and capital leases	172,750	74,183
Total long-term debt	$ 3,514,008	$ 1,650,652

Debt issuance	Interest rate mode	Interest rates	Payment ranges and maturity *(in thousands of dollars)*
The Pennsylvania State University Bonds			
Series 2020A	Fixed	4.00% - 5.00%	$1,195 to $3,090 through September 2040 with $17,980 and $22,490 due September 2045 and 2050, respectively
Series 2020B	Fixed	1.449% - 2.888%	$5,650 to $13,910 through September 2035 with $67,170 and $89,310 due September 2040 and 2050, respectively
Series 2020D	Fixed	1.09% - 2.84%	$25,480 to $33,545 through September 2035 with $304,225 and $328,000 due September 2043 and 2050, respectively
Series 2020E	Fixed	5.00%	$4,520 to $7,010 through March 2031
Series 2019A	Fixed	5.00%	$1,575 to $6,720 through September 2049
Series 2019B	Fixed	2.05% - 3.50%	$2,555 to $3,720 through September 2034 with $20,455 and $52,515 due September 2039 and September 2049, respectively
Series 2018	Fixed	2.00% - 5.00%	$1,020 to $2,320 through September 2037 with $16,650 and $18,255 due September 2043 and September 2048, respectively
Series 2017A	Fixed	2.00% - 5.00%	$2,630 to $5,965 through September 2037 with $34,750 and $44,620 due September 2042 and September 2047, respectively
Series 2017B	Fixed	1.777% - 3.793%	$2,740 to $3,830 through September 2032 with $21,305 and $56,595 due September 2037 and September 2047, respectively
Series 2016A	Fixed	5.00%	$2,965 to $6,465 through September 2036 with $37,520 due September 2041
Series 2016B	Fixed	4.00% - 5.00%	$7,165 to $22,195 through September 2036
Series 2015A	Fixed	5.00%	$1,660 to $3,445 through September 2035 with $20,000 due September 2040
Series 2015B	Fixed	5.00%	$4,180 to $8,435 through September 2035
Series 2007B	Fixed	5.25%	$4,125 to $5,955 through August 2027
Pennsylvania Higher Educational Facilities Authority ("PHEFA") University Revenue Bonds			
Series 2006	Fixed	4.400% - 5.125%*	$280 due September 2020 and $1,610 due September 2025
Series 2004	Fixed	5.00%*	$1,905 due September 2024
Series 2002	Fixed	5.00%*	$2,435 due March 2022

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

Debt issuance	Interest rate mode	Interest rates	Payment ranges and maturity
Penn State Health Bonds			
Series 2019	Fixed	3.806%	$200,000 due November 2049

Cumberland County Municipal Authority Revenue Bonds			
Series 2019	Fixed	3.00% - 5.00%	$4,915 to $9,315 through November 2039 with $52,355 and $63,940 due November 2044 and November 2049, respectively
Lycoming County Authority College Revenue Bonds			
Series 2016	Fixed	2.125% - 5.00%	$1,930 to $3,615 through October 2032 with $19,345 due October 2037
Series 2015	Fixed	2.50% - 3.29%	$465 to $625 through January 2025
Series 2012	Fixed	3.00% - 5.00%	$2,565, $6,395 and $12,045 due May 2022, May 2026 and May 2032, respectively
Series 2011	Fixed	4.00% - 5.24%	$1,590 to $1,850 through July 2021 with $14,170 and $18,705 due July 2026 and July 2030, respectively

The Series 2020A Bonds are general obligation bonds issued in March 2020 for the purpose of financing various construction and renovation projects. The Series 2020A Bonds are subject to early redemption provisions, at the option of the University, beginning September 2030. The bonds maturing in September 2045 and September 2050 are subject to mandatory sinking fund redemption.

The Series 2020B Bonds are taxable general obligation bonds issued in March 2020 for the purpose of financing the general corporate purposes of the University and the current refunding and defeasance of all of the outstanding Series 2010 Bonds. The Series 2020B Bonds are subject to optional redemption provisions prior to maturity, in such order of their maturity as directed by the University, at the make-whole redemption price. The bonds maturing in September 2040 and September 2050 are subject to mandatory sinking fund redemption. In conjunction with the issuance of the Series 2020B Bonds, the University legally defeased the Series 2010 Bonds by irrevocably depositing the required funds in an escrow fund to be used to pay interest accrued, maturing principal, and redemption price of the refunded bonds.

The Series 2020D Bonds are taxable general obligation bonds issued in May 2020 for the purpose of financing the current refunding and defeasance of all of the outstanding Series 2020C Notes. The Series 2020D Bonds are subject to optional redemption provisions prior to maturity, in such order of their maturity as directed by the University, at the make-whole redemption price. The bonds maturing in September 2043 and September 2050 are subject to mandatory sinking fund redemption. In conjunction with the issuance of the Series 2020D Bonds, the University legally defeased the Series 2020C Notes by irrevocably depositing the required funds used to pay interest accrued, maturing principal, and redemption price of the refunded notes at, or prior to, the redemption date. The Series 2020C Notes were taxable notes issued in April 2020 for the purpose of the Commonwealth of Pennsylvania State Employees' Retirement System ("SERS") prefunding, as described in Note 11.

The Series 2020E Bonds are general obligation bonds issued in May 2020 for the purpose of financing the current refunding and defeasance of all of the outstanding Series 2009B Bonds. The Series 2020E Bonds are subject to early redemption provisions, at the option of the University, beginning March 2030. In conjunction with the issuance of the Series 2020E Bonds, the University legally defeased the Series 2009B Bonds by irrevocably depositing the required funds used to pay interest accrued, maturing principal, and redemption price of the refunded bonds at, or prior to, the redemption date.

The Penn State Health Taxable Bonds, Series 2019 and the Cumberland County Municipal Authority Revenue Bonds, Series 2019 were issued in November 2019 by the Health System for the purpose of financing capital projects, acquiring the administrative office, paying off intercompany debt, and financing general corporate purposes.

The University believes it has complied with all financial debt covenants for the years ended June 30, 2020 and 2019.

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

Year	Annual Installments *(in thousands of dollars)*
2021	$ 51,040
2022	84,100
2023	86,750
2024	89,490
2025	92,280
Thereafter	2,743,390
	$ 3,147,050

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, 2020, the carrying value and estimated fair value of the University's bonds payable, including issuance premiums and deferred bond costs, are $3,341.3 million and $3,466.8 million, respectively. At June 30, 2019, the carrying value and estimated fair value of the University's bonds payable, including issuance premiums and deferred bond costs, were $1,576.5 million and $1,596.8 million, respectively. Certain bond issues have associated issuance premiums; these issuance premiums total $208.4 million and $164.0 million at June 30, 2020 and 2019, respectively, and are presented within the statement of financial position as long-term debt. These issuance premiums will be amortized over the term of the respective outstanding bonds. Certain bond issues have associated deferred bond costs; these deferred bond costs total $14.2 million and $6.5 million at June 30, 2020 and 2019, respectively, and are presented within the statement of financial position as a reduction in long-term debt. These deferred bond costs will be amortized over the term of the respective outstanding bonds.

Notes payable, lines of credit and capital leases

The University has four notes payable included within the consolidated statements of financial position at June 30, 2020 with balances of $4.7 million, $5.9 million, $7.4 million, and $6.7 million. These notes have payments due through June 2024, June 2025, March 2026, and August 2039 and bear interest at 2.60%, 2.85%, 2.80%, and 3.52%, respectively. The current portion of payments due under these notes totals $3.7 million at June 30, 2020.

During 2020, the Health System established several lines of credit to serve as a bridge to meet capital and operating needs. In April 2020, the Health System established a revolving line of credit with PNC Bank in the amount of $75.0 million, with $25.0 million reserved for letters of credit, expiring in April 2021. The interest on this line of credit is LIBOR-based, with a commitment fee on the undrawn portion. As of June 30, 2020, the Health System had drawn $50.0 million on the line.

In April 2020, the Health System established a revolving line of credit with Fulton Bank in the amount of $55.0 million. Interest on the line of credit is LIBOR-based, with a commitment fee on the undrawn portion. The commitment fee commences after April 2021. The line of credit expires in April 2022. As of June 30, 2020, the Health System had drawn $55.0 million on the line.

In April 2020, the Health System established a revolving line of credit with Huntington Bank in the amount of $100.0 million. Interest on the line of credit is LIBOR-based, with a commitment fee on the undrawn portion. The line of credit expires in April 2022. As of June 30, 2020, the Health System had not drawn on the line.

As of June 30, 2020, the Health System had a total draw on these lines of credit of $105.0 million, which is reflected in the current portion of long-term debt.

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, 2020 are as follows:

Year	*(in thousands of dollars)*
2021	$ 10,916
2022	7,424
2023	5,841
2024	4,706
2025	3,399
Thereafter	23,489
Total minimum lease payments	55,775
Less imputed interest	(12,713)
Capital lease obligation	43,062
Current portion	9,193
Long-term portion	$ 33,869

9. OPERATING LEASES

The University has certain lease agreements in effect which are considered operating leases. During the year ended June 30, 2020, the University recorded expenses of $19.0 million for leased equipment and $36.3 million for leased building space. During the year ended June 30, 2019, the University recorded expenses of $22.6 million for leased equipment and $37.7 million for leased building space.

Future minimum lease payments under operating leases as of June 30, 2020 are as follows:

Year	*(in thousands of dollars)*
2021	$ 28,831
2022	23,096
2023	16,659
2024	14,159
2025	11,779
Thereafter	51,465
Total minimum lease payments	$ 145,989

10. FUNCTIONAL AND NATURAL CLASSIFICATION OF EXPENSES

Functional expenses by natural classification as of June 30, 2020 are as follows:

(in thousands of dollars)	Educational and General	Auxiliary Enterprises	Health System	Total
Salaries and wages	$ 1,775,559	$ 106,226	$ 1,223,310	$ 3,105,095
Benefits	568,733	49,086	302,936	920,755
Depreciation	293,713	37,597	104,912	436,222
Plant operations and maintenance	116,773	13,592	56,307	186,672
Other components of net periodic postretirement benefit cost	79,140	451	-	79,591
Interest	25,123	27,372	9,669	62,164
Supplies, services, and other	762,475	204,185	909,590	1,876,250
Total	$ 3,621,516	$ 438,509	$ 2,606,724	$ 6,666,749

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

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

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

11. RETIREMENT BENEFITS

The University provides retirement benefits for substantially all regular employees, primarily through either contributory defined benefit plans administered by SERS and The Public School Employees' Retirement System or defined contribution plans administered by the Teachers Insurance and Annuity Association. The University is billed for its share of the estimated actuarial cost of the defined benefit plans ($131.2 million and $125.8 million for the years ended June 30, 2020 and 2019, respectively). The Health System provides retirement benefits for substantially all employees through one of three defined contribution plans administered by Empower Retirement. The University's total cost for retirement benefits, included in expenses, is $299.0 million and $285.2 million for the years ended June 30, 2020 and 2019, respectively.

The SERS is the administrator of a cost-sharing, multi-employer retirement system established by the Commonwealth of Pennsylvania to provide pension benefits for employees of state government and certain independent agencies. As provided by statute, the SERS Board of Trustees has exclusive control and management responsibility of the funds and full power to invest the funds. The SERS funding policy provides for periodic member contributions at statutory rates and employer contributions at actuarially determined rates (expressed as a percentage of annual gross pay) that are sufficient to accumulate assets to pay benefits when due. The University's contributions to this plan for the years ended June 30, 2020 and 2019 were $127.8 million and $122.7 million, respectively, and represent approximately 6.1% of total contributions to the plan based on projections for fiscal year 2020. The plan is funded at less than 65% with the funded ratio of the plan at 56.5% as of December 31, 2019.

In April 2020, the University entered into an agreement with SERS to prefund $1.061 billion of the University's unfunded actuarial accrued liability in exchange for credits against future contributions. The pension prefunding expense is included within nonoperating activities in the consolidated statement of activities for the year ended June 30, 2020.

12. POSTRETIREMENT BENEFITS

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

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

- they are at least age 60 and have at least 15 years of continuous regular full-time employment and participation in a University-sponsored medical plan immediately preceding the retirement date
- regardless of age, if they have at least 25 years of regular full-time service. The last 10 of those 25 years of University service must be continuous and they must participate in a University-sponsored medical plan during the last 10 years immediately preceding the retirement date.

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

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

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

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

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

Included in net assets without donor restrictions at June 30, 2020 and 2019 are the following amounts that have not yet been recognized in net periodic postretirement cost: unrecognized prior service cost (benefit) of ($0.9) million and ($2.5) million and unrecognized actuarial loss of $447.7 million and $396.9 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)

	2020	2019
Benefit obligation at beginning of year	$ 2,224,035	$ 2,193,555
Service cost	40,397	41,329
Interest cost	79,242	89,066
Actuarial gain	(175,759)	(171,326)
Benefits paid	(51,631)	(46,617)
Plan amendment	-	-
Plan assumptions	228,530	118,028
Benefit obligation at end of year	$ 2,344,814	$ 2,224,035

Change in plan assets:
(in thousands of dollars)

	2020	2019
Fair value of plan assets at beginning of year	$ -	$ -
Employer contributions	51,631	46,617
Benefits paid	(51,631)	(46,617)
Fair value of plan assets at end of year	$ -	$ -
Funded status	$ (2,344,814)	$ (2,224,035)
Unrecognized prior service cost (benefit)	-	-
Unrecognized net actuarial loss	-	-
Accrued postretirement benefit expense	$ (2,344,814)	$ (2,224,035)

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

	2020	2019
Operating expenses:		
Service cost	$ 40,397	$ 41,329
Nonoperating activities:		
Interest cost	79,242	89,066
Amortization of prior service cost	(1,574)	(1,574)
Amortization of unrecognized net loss	1,923	9,480
Net periodic postretirement cost	$ 119,988	$ 138,301

The assumed healthcare cost trend rate used in measuring the accumulated postretirement benefit obligation was 6.70% and 6.90% for the years ended June 30, 2020 and 2019, respectively, reduced each year to an ultimate level of 5.00%. The postretirement benefit obligation discount rate was 3.22% and 3.92% for the years ended June 30, 2020 and 2019, respectively. During 2020, the plan had favorable claims experience compared to assumptions and the permanent repeal of the excise tax also created favorable results. During 2019, the plan also had favorable claims experience compared to assumptions in addition to positive results related to the change in the mortality table and improvement scale.

If the healthcare cost trend rate assumptions were increased by 1% in each year, the accumulated postretirement benefit obligation would be increased by $501.9 million and $461.6 million as of June 30, 2020 and 2019, 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 $28.7 million and $30.8 million as of June 30, 2020 and 2019, respectively. If the healthcare cost trend rate assumptions were decreased by 1% in each year, the accumulated postretirement benefit obligation would be decreased by $387.6 million and $367.7 million as of June 30, 2020 and 2019, 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 $21.7 million and $23.3 million as of June 30, 2020 and 2019, 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)
2021	$ 57,273
2022	61,902
2023	66,527
2024	71,563
2025	76,322
2026-30	442,718

13. PENN STATE HEALTH

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

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

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

In January 2016, the ownership of Nittany transferred from the University to the Health System. Nittany (formerly Penn State Hershey Health System, Inc.) is a corporate investor in healthcare joint ventures, which are supportive of the missions of the Health System. Nittany's objectives are consistent with the strategic objective to extend the range of healthcare services offered by and through the Health System over a broader geographic region. Nittany recorded non-controlling interest related to the acquisition of additional ownership interest in a joint venture. This non-controlling interest is recorded in net assets without donor restrictions within the consolidated statements of financial position with a value at June 30, 2020 and 2019 of $2.1 million.

In May 2016, the ownership of MSHMC transferred from the University to the Health System. At June 30, 2020, MSHMC is a 548-bed, not-for-profit acute care, academic medical center located in Hershey, Pennsylvania. The University retains ownership of the buildings and land occupied by MSHMC, which is co-located with the University's College of Medicine. The clinical facilities of the Medical Center complex are leased to MSHMC. MSHMC makes certain payments to support the College of Medicine. MSHMC is a Level 1 Regional Trauma Center and provides inpatient, outpatient, and emergency care services to residents of central Pennsylvania through its central facility in Hershey and 36 medical group sites. Additionally, MSHMC operates an ambulatory surgical center, which provides endoscopy procedures to the Centre County Region.

In February 2017, the Health System established PSCMG. The purpose of PSCMG is to extend the ambulatory clinical footprint of the Health System into a broader geographic region. In October 2017, the Health System, through an asset purchase agreement, began operations of 18 medical group sites. As of June 30, 2020, PSCMG has 26 medical group sites.

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

In October 2017, the Health System established Hampden. The purpose of Hampden Medical Center was to acquire property in Cumberland County, which is intended to be the future site of an acute care hospital. The land acquisition took place in October 2017.

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

In June 2020, the Health System established the Penn State Health Life Lion, LLC. The purpose of Penn State Health Life Lion, LLC is to provide emergency medical services into a broader geographic region.

In January 2018, Highmark Health purchased a 20% minority interest in the Health System. The Health System received contributed capital in exchange for three board seats and certain reserve powers. Additionally, the Health System recorded non-controlling interest, excess of revenues over expenses, related to this minority interest. The total non-controlling interest related to Highmark Health is recorded in net assets without donor restrictions within the consolidated statements of financial position with a value at June 30, 2020 and 2019 of $257.0 million and $250.1 million, respectively.

During 2020 and 2019, the Health System received cash contributions related to the Community Health Reinvestment Act from Highmark Health. The cash contributions of $30.0 million are recorded as Health System revenue on the consolidated statements of activities. Additionally, during 2020 and 2019, the Health System paid Highmark Health $174.3 million and $161.6 million, respectively, related to employee benefit expenses and recorded $512.4 million and $577.5 million, respectively, in net patient revenue related to Highmark Health Third Party Payor contracts. During 2020, the Health System recorded a liability due to Highmark Health in the amount of $3.1 million. This liability is related to a contractual agreement between the parties and is included in accounts payable and other accrued expenses in the consolidated statements of financial position.

On November 1, 2020, the Health System completed a member substitution agreement whereby the Health System became the parent company of Holy Spirit Health System and its subsidiaries. No cash was paid as part of this transaction. The valuation of the transaction is in process.

14. CONTINGENCIES AND COMMITMENTS

Contractual Obligations

The University has contractual obligations for the construction of new buildings and for additions to existing buildings in the amount of $1,349.8 million, of which $1,005.6 million has been paid or accrued as of June 30, 2020. 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 $45.8 million and $37.8 million as of June 30, 2020 and 2019, respectively. These letters of credit are used primarily to comply with minimum state and federal regulatory laws that govern various University activities. The fair value of these letters of credit approximates contract values based on the nature of the fee arrangements with the issuing banks.

Guarantees

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

Self-Insurance

The University has a coordinated program of commercial and self-insurance for medical malpractice claims for the Health System 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, 2020 and 2019, of the medical malpractice claims liability in the amount of $157.3 million and $166.3 million is recorded as of June 30, 2020 and 2019, respectively.

The subsidiaries of the Health System are self-insured for all medical malpractice claims asserted on or after July 1, 2001, for all amounts that are below the coverage of excess insurance policies and not included in the insurance coverage of the MCARE Fund. Under the self-insurance program, the Health System is required to maintain a malpractice trust fund in an amount at least equal to the expected loss of known claims. The balance of this trust fund was $29.8 million and $32.1 million at June 30, 2020 and 2019, respectively. The Health System intends to fund any claims due during the next year from cash flows from operations.

With approval from the Pennsylvania Department of Labor and Industry (“PA-DLI”), the University elected to self-insure potential obligations applicable to Pennsylvania workers' compensation. Claims under the program are contractually administered by a third-party administrator. The University purchased insurance coverage from a commercial insurer for claims in excess of $600,000 per incident. An estimate of the self-insured workers' compensation claims liability in the amount of $7.8 million and $7.2 million, discounted at 0.29% and 1.76%, respectively, is recorded as of June 30, 2020 and 2019, respectively. The University has established a trust fund, in the amount of $14.5 million and $13.8 million at June 30, 2020 and 2019, respectively, as required by PA-DLI, to provide for the payment of claims under this self-insurance program. The Health System is self-insured for workers' compensation claims and has purchased excess policies through commercial insurers which cover individual claims in excess of $750,000 per incident for workers' compensation claims.

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

Litigation and Contingencies

Various 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.

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

15. SUBSEQUENT EVENTS

The University has evaluated subsequent events through November 4, 2020, 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.

In July 2020, the University issued two lines of credit totaling $250 million to provide support for its liquidity position in the wake of the COVID-19 pandemic. As of the date on which the consolidated financial statements were issued, $50 million has been drawn on these lines of credit.

THE PENNSYLVANIA STATE UNIVERSITY