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Audited Financial Statements

The Pennsylvania State University
Fiscal Year Ended June 30, 2013

THE PENNSYLVANIA STATE UNIVERSITY

UNIVERSITY OFFICERS
as of November 1, 2013

RODNEY A. ERICKSON
President

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

NICHOLAS P. JONES
Executive Vice President
and Provost

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

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

THE PENNSYLVANIA STATE UNIVERSITY

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VIRTUE LIBERTY AND INDEPENDENCE

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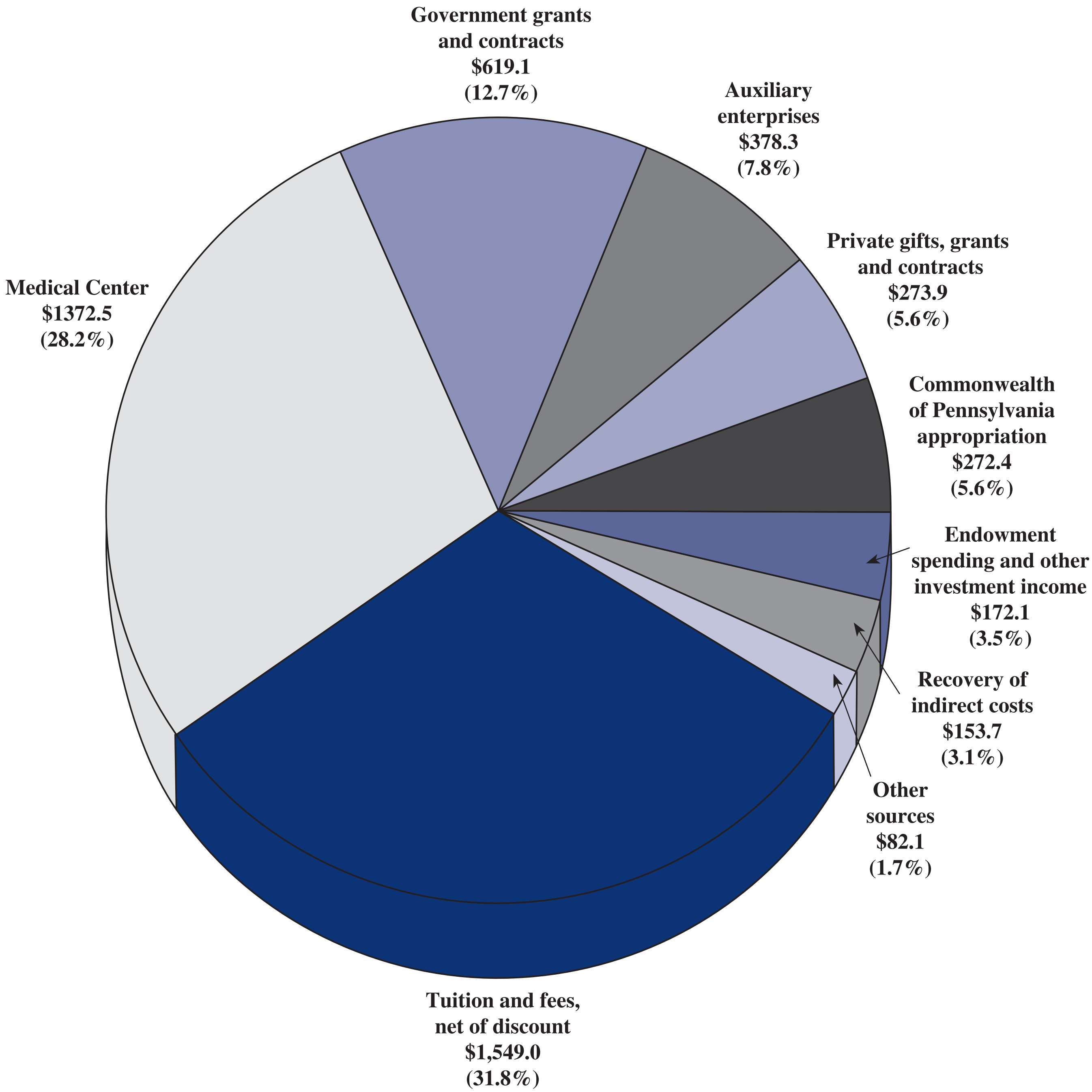
OPERATING REVENUES BY SOURCE ($4.9 billion)

For the Year Ended June 30, 2013

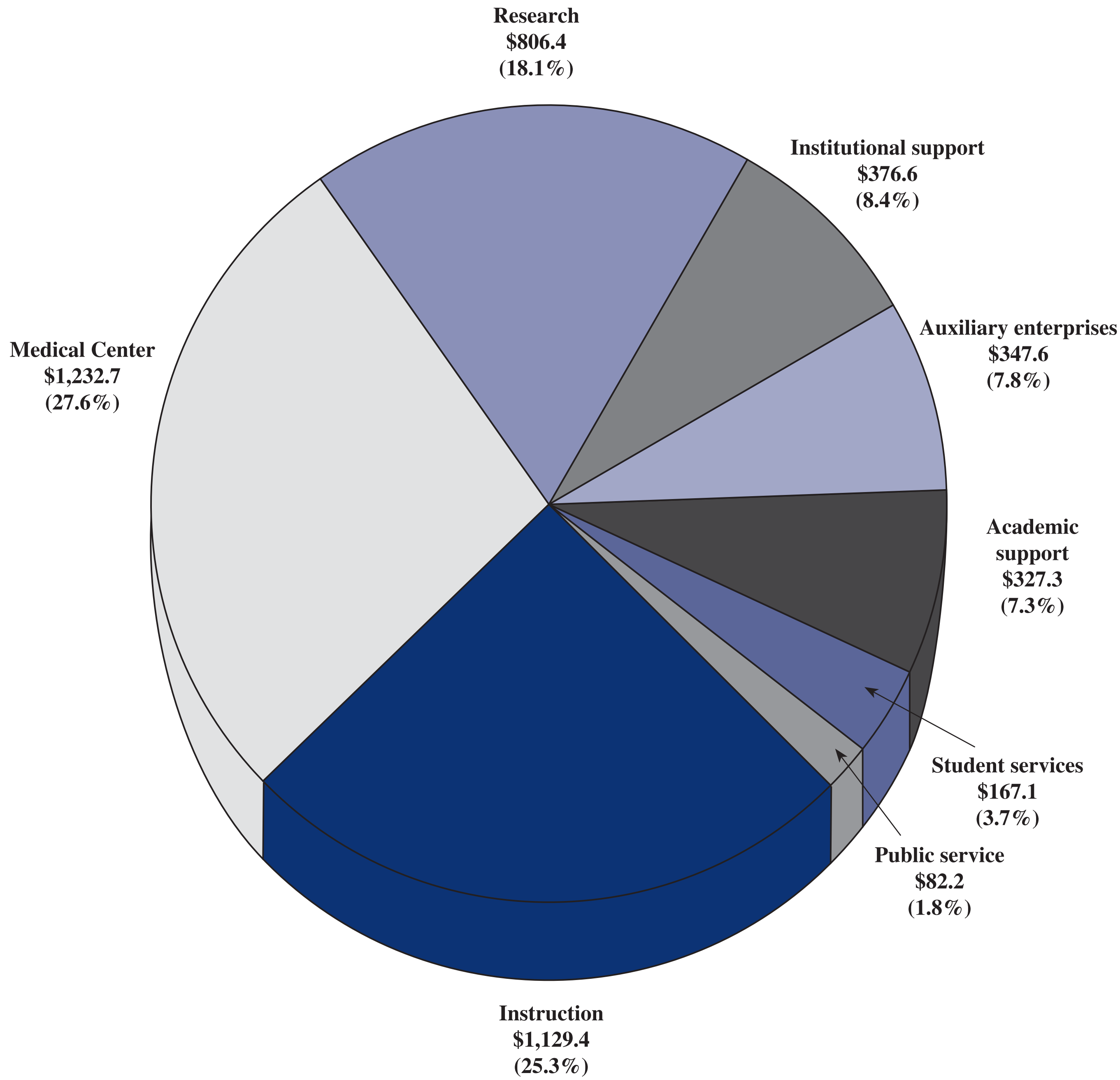
($ in Millions)



OPERATING EXPENSES BY FUNCTION ($4.5 billion)

For the Year Ended June 30, 2013

($ in Millions)



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

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

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

November 1, 2013

Dr. Rodney A. Erickson, President
The Pennsylvania State University

Dear Dr. Erickson:

The audited consolidated financial statements of The Pennsylvania State University and subsidiaries (the "University") for the fiscal years ended June 30, 2013 and 2012 are presented on the accompanying pages. These financial statements represent a complete and permanent record of the finances of the University as of and for the years then ended.

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

Respectfully submitted,

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

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

Deloitte & Touche LLP
1700 Market Street
Philadelphia, PA 19103-3984
USA

Tel: 215 246 2300
Fax: 215 569 2441
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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, 2013 and 2012, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company'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 Company'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, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

November 1, 2013

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
ASSETS
JUNE 30, 2013 AND 2012
(in thousands)

	June 30, 2013	June 30, 2012
Current assets:		
Cash and cash equivalents	$ 983,256	$ 1,599,863
Short-term investments	200,273	256,882
Deposits held for others	44,166	26,016
Accounts receivable, net of allowances of $66,974 and $62,217	492,404	383,173
Contributions receivable, net	50,411	67,038
Loans to students, net of allowances of $584 and $486	10,683	10,317
Inventories	31,406	30,769
Prepaid expenses and other assets	115,463	94,562
Total current assets	1,928,062	2,468,620
Noncurrent assets:		
Deposits held by bond trustees	2,551	2,551
Contributions receivable, net	127,726	117,375
Loans to students, net of allowances of $2,497 and $2,247	48,161	47,693
Deferred bond costs, net	5,181	6,241
Total investment in plant, net	3,730,764	3,547,803
Beneficial interest in perpetual trusts	13,252	12,891
Investments	4,816,961	3,794,668
Other assets	17,958	23,147
Total noncurrent assets	8,762,554	7,552,369
Total assets	$ 10,690,616	$ 10,020,989

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
LIABILITIES AND NET ASSETS
JUNE 30, 2013 AND 2012
(in thousands)

	June 30, 2013	June 30, 2012
Current liabilities:		
Accounts payable and other accrued expenses	$ 660,096	$ 524,705
Deferred revenue	264,727	244,104
Long-term debt	43,650	44,671
Present value of annuities payable	5,276	5,536
Accrued postretirement benefits	51,390	42,470
Total current liabilities	1,025,139	861,486
Noncurrent liabilities:		
Deposits held in custody for others	50,804	47,556
Deferred revenue	6,969	9,487
Long-term debt	961,758	1,108,035
Present value of annuities payable	36,979	37,631
Accrued postretirement benefits	1,643,651	1,822,429
Refundable United States Government student loans	45,300	44,478
Other liabilities	210,919	222,889
Total noncurrent liabilities	2,956,380	3,292,505
Total liabilities	3,981,519	4,153,991
Net assets:		
Unrestricted -		
Undesignated	1,635	1,617
Designated for specific purposes	2,757,846	2,193,627
Net investment in plant	2,246,228	2,044,408
Total unrestricted - The Pennsylvania State University	5,005,709	4,239,652
Noncontrolling interest	831	774
Total unrestricted	5,006,540	4,240,426
Temporarily restricted	484,375	482,208
Permanently restricted	1,218,182	1,144,364
Total net assets	6,709,097	5,866,998
Total liabilities and net assets	$ 10,690,616	$ 10,020,989

See notes to consolidated financial statements.

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

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

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2012
(in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating revenues and other support:				
Tuition and fees, net of discounts of $121,979	$ 1,508,843	$ -	$ -	$ 1,508,843
Commonwealth of Pennsylvania -				
Appropriations	261,046	-	-	261,046
Special contracts	67,949	-	-	67,949
Department of General Services projects	28,142	-	-	28,142
United States Government grants and contracts	476,987	-	-	476,987
Private grants and contracts	173,401	-	-	173,401
Gifts and pledges	80,765	9,927	-	90,692
Endowment spending	70,843	-	-	70,843
Other investment income	59,303	553	-	59,856
Sales and services of educational activities	60,297	-	-	60,297
Recovery of indirect costs	151,452	-	-	151,452
Auxiliary enterprises	377,375	-	-	377,375
Medical Center revenue	1,261,690	-	-	1,261,690
Other sources	28,438	-	-	28,438
Net assets released from restrictions	55,669	(55,669)	-	-
Total operating revenues and other support	4,662,200	(45,189)	-	4,617,011
Operating expenses:				
Educational and general -				
Instruction	1,080,767	-	-	1,080,767
Research	756,608	-	-	756,608
Public service	87,212	-	-	87,212
Academic support	304,846	-	-	304,846
Student services	158,649	-	-	158,649
Institutional support	277,147	-	-	277,147
Total educational and general	2,665,229	-	-	2,665,229
Auxiliary enterprises	387,120	-	-	387,120
Medical Center expense	1,195,695	-	-	1,195,695
Total operating expenses	4,248,044	-	-	4,248,044
Increase/(decrease) in net assets from operating activities	414,156	(45,189)	-	368,967
Nonoperating activities:				
Gifts and pledges	-	-	33,653	33,653
Current year investment returns	49,555	(27,795)	5,125	26,885
Endowment appreciation utilized	(33,131)	-	-	(33,131)
Changes in funds held by others in perpetuity	-	375	51	426
Write-offs and disposals of assets	(6,407)	-	-	(6,407)
Nonperiodic change in postretirement benefit plan	(295,287)			(295,287)
Actuarial adjustment on annuities payable	-	(558)	(3,736)	(4,294)
(Decrease)/increase in net assets from nonoperating activities	(285,270)	(27,978)	35,093	(278,155)
Increase/(decrease) in net assets - The Pennsylvania State University	128,886	(73,167)	35,093	90,812
Noncontrolling interest:				
Excess of revenues over expenses	80	-	-	80
Increase in net assets noncontrolling interest	80	-	-	80
Increase/(decrease) in total net assets	128,966	(73,167)	35,093	90,892
Net assets at the beginning of the year	4,111,460	555,375	1,109,271	5,776,106
Net assets at the end of the year	$ 4,240,426	$ 482,208	$ 1,144,364	$ 5,866,998

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012
(in thousands)

	June 30, 2013	June 30, 2012
Cash flows from operating activities:		
Increase in net assets	$ 842,099	$ 90,892
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Actuarial adjustment on annuities payable	4,366	4,294
Contributions restricted for long-term investment	(100,126)	(97,224)
Interest and dividends restricted for long-term investment	(61,553)	(23,206)
Net realized and unrealized gains on long-term investments	(132,907)	(37,231)
Depreciation expense	251,407	242,531
Amortization expense	480	505
(Gain)/loss on early extinguishment of debt	(213)	567
Write-offs and disposals of assets	16,000	6,407
Contributions of land, buildings and equipment	(14,821)	(2,755)
Buildings and equipment provided by Pennsylvania Department of General Services	(1,293)	-
Contribution to government student loan funds	154	154
Provision for bad debts	49,433	57,555
Increase in deposits held for others	(40,601)	(1,563)
Increase in receivables	(90,238)	(44,410)
(Increase)/decrease in inventories	(503)	4,821
Decrease/(increase) in prepaid expenses and other assets	14,598	(4,164)
Increase in accounts payable and other accrued expenses	80,820	125,353
Increase in deferred revenue	18,564	8,424
(Decrease)/increase in accrued postretirement benefits	(169,858)	385,855
Net cash provided by operating activities	665,808	716,805
Cash flows from investing activities:		
Purchase of land, buildings and equipment	(434,933)	(402,654)
Decrease in deposits held by bond trustees	-	57,100
Advances on student loans	(9,836)	(10,482)
Collections on student loans	8,320	7,025
Decrease in investments held under securities lending program	-	219,524
Decrease in liability under securities lending program	-	(219,524)
Purchase of investments	(40,907,840)	(34,460,283)
Proceeds from sale of investments	40,068,438	34,056,053
Net cash used in investing activities	(1,275,851)	(753,241)
Cash flows from financing activities:		
Contributions restricted for long-term investment	100,126	95,934
Interest and dividends restricted for long-term investment	61,553	23,206
Payments of annuity obligations	(5,297)	(5,558)
Proceeds from issuance of bonds	-	26,256
Bond issuance costs	-	(301)
Principal payments on notes, bonds and capital leases	(163,604)	(72,864)
Proceeds related to government student loan funds, net of collection costs	658	611
Net cash (used in)/provided by financing activities	(6,564)	67,284
Net (decrease)/increase in cash and cash equivalents	(616,607)	30,848
Cash and cash equivalents at the beginning of the year	1,599,863	1,569,015
Cash and cash equivalents at the end of the year	$ 983,256	$ 1,599,863

Supplemental disclosures of cash flow information (Note 2)

See notes to consolidated financial statements.

1. THE UNIVERSITY AND RELATED ENTITIES

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

Basis of Presentation

The financial statements of the University include, on a consolidated basis, the combined financial statements of The Milton S. Hershey Medical Center ("TMSHMC" or "Medical Center"), a not-for-profit corporation and Penn State Hershey Health System, Inc. ("Health System") and The Corporation for Penn State and its subsidiaries ("the Corporation"). See Note 11 for additional information about TMSHMC and the Health System. The Corporation is a non-profit member corporation organized in 1985 for the exclusive purpose of benefiting and promoting the interests of the University, the Corporation's sole member. The Corporation's financial statements consist primarily of the assets and revenues of The Pennsylvania College of Technology ("Penn College"), a wholly-owned subsidiary of the Corporation. All significant transactions between the University, TMSHMC and the Corporation have been eliminated.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

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

The University's consolidated financial statements include statements of financial position, activities and cash flows. In accordance with FASB ASC requirements, net assets and the changes in net assets are classified as permanently restricted, temporarily restricted or unrestricted.

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

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

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

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

Use of Estimates

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

Revenue Recognition

Tuition revenue is recognized in the fiscal year in which the substantial portion of the educational term occurs. Institutional financial aid provided by the University for tuition and fees is reflected as a reduction of tuition and fee revenue. Revenues for auxiliary enterprises are recognized as the related goods and services are delivered and rendered. Grant revenues are recognized as the eligible grant activities are conducted. Payments received in advance for tuition, goods and services are deferred.

Unconditional promises to give are recognized as revenues and receivables in the year made and consist of written or oral promises to contribute to the University in the future. Contributions receivable are recorded with the revenue assigned to the appropriate category of restriction. The amounts are present valued based on timing of expected collections.

TMSHMC and Health System have agreements with third-party payors that provide for payments to TMSHMC and Health System at amounts different from their established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. In addition, net patient service revenue is net of provision for bad debts of $43.6 million and $51.6 million for the years ended June 30, 2013 and 2012, respectively. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined or such estimates change.

TMSHMC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. The Medical Center does not pursue collection of amounts determined to qualify as charity care; they are not reported as net patient service revenue. The amounts of direct and indirect costs for services and supplies furnished under the Medical Center’s charity care policy totaled approximately $20.0 million and $17.6 million for the years ended June 30, 2013 and 2012, respectively and is based on a ratio of the Medical Center’s operational costs to its gross charges. The amount of charges foregone for services and supplies furnished under the Medical Center’s charity policy during 2013 and 2012 totaled approximately $54.9 million and $51.7 million, respectively.

Fair Value of Financial Instruments

The University has provided fair value estimates for certain financial instruments in the notes to the financial statements. Fair value information presented in the financial statements is based on information available at June 30, 2013 and 2012. 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, 2013 and 2012 have been made at the rates available to students for similar loans at such times. Investments are reported at fair value as disclosed in Note 3. The fair value of the University's bonds payable is disclosed in Note 7. See Note 5 for further discussion of fair value measurements.

Cash Flows

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

(in thousands of dollars)	2013	2012
Interest paid	$ 46,798	$ 48,569
Taxes paid	7	1,500
Non-cash acquisitions of land, buildings and equipment	32,723	11,638

Capitalized construction costs accrued are $44.8 million and $61.3 million as of June 30, 2013 and 2012, respectively. Cash and cash equivalents include certain investments in highly liquid instruments with initial maturities of 90 days or less, except for such assets held by the University's investment managers as part of their long-term investment strategies. Short-term investments include other current investments held for general operating purposes with maturities greater than three months but less than 12 months.

Accounts Receivable

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

(in thousands of dollars)	2013	2012
Grants and contracts, net of allowance of $1,241 and $1,241	$ 166,963	$ 149,397
Patient accounts receivable, net of allowance of $54,759 and $51,544	173,582	146,034
Student receivables, net of allowance of $6,434 and $5,418	33,178	42,805
Investment and interest receivable	78,419	16,967
Other, net of allowance of $4,540 and $4,014	40,262	27,970
Total accounts receivable, net	$ 492,404	$ 383,173

The University maintains allowances for doubtful accounts to reflect management's best estimate of probable losses inherent in receivable balances. Management determines the allowances for doubtful accounts based on known factors, historical experience, and other currently available evidence. Receivables are written off when management determines they will not be collected.

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

Loans to Students

Loans to students are disbursed to qualified students based on need and include loans granted by the University from institutional resources and under federal government loan programs. Students have a grace period until repayment is required based upon the earlier of graduation or no longer achieving at least half-time enrollment status. The grace period varies depending on the type of loan. Loans accrue interest after the grace period and are repaid directly to the University. Loans to students are uncollateralized and carry default risk. At June 30, 2013 and 2012, respectively, student loans represent 0.6% of total assets.

The availability of funds for loans under federal government revolving loan programs is dependent on reimbursements to the pool from repayments of outstanding loans. Funds advanced by the federal government of $45.3 million and $44.5 million at June 30, 2013 and 2012, respectively, are ultimately refundable to the government and are classified as liabilities in the consolidated statements of financial position. Outstanding loans cancelled under the program result in a reduction of the funds available to loan and a decrease in the liability to the federal government.

At June 30, 2013 and 2012, loans to students consisted of the following:

(in thousands of dollars)	2013	2012
Loans to students:		
Federal government loan programs:		
Perkins loan program	$ 42,789	$ 42,294
Health Professions Student Loans and Loans for Disadvantaged Students	197	285
Federal government loan programs	42,986	42,579
Institutional loan programs	18,939	18,164
	61,925	60,743
Less allowance for doubtful accounts:		
Balance, beginning of year	(2,733)	(2,753)
Provision for doubtful accounts	(348)	20
Balance, end of year	(3,081)	(2,733)
Loans to students, net	$ 58,844	$ 58,010

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, 2013 and 2012 are as follows:

(in thousands of dollars)

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

	(in thousands of dollars)				
2012	30 days or less	31-60 days	61-90 days	Over 91 days	Total
Loans to students:					
Federal government loan programs	$ 41,069	$ 506	$ 111	$ 893	$ 42,579
Institutional loan programs	17,781	173	28	182	18,164
Total loans to students	58,850	679	139	1,075	60,743
Allowance for doubtful accounts:					
Federal government loan programs					(1,562)
Institutional loan programs					(1,171)
Total allowance for doubtful accounts					(2,733)
Total loans to students, net					$ 58,010

Inventories

Inventories are stated at the lower of cost or market, generally on the first-in, first-out basis.

Investments

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

The estimated fair value amounts for marketable debt, equity and fixed income securities held by the University have been reviewed by the University and determined using available market information as supplied by the various financial institutions that act as trustees or custodians for the University. For non-liquid holdings, generally limited partnership investments in private real estate, venture capital, private equity, natural resources, and private debt, estimated fair value is determined based upon financial information provided by the general partner. This financial information includes assumptions and methods that were reviewed by University management. The University believes that the estimated fair value is a reasonable estimate of market value as of June 30, 2013 and 2012. Because the limited partnerships are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market existed, and such differences could be material.

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

Beneficial Interest in Perpetual Trusts

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

Investment in Plant

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

(in thousands of dollars)	2013	2012
Land	$ 116,050	$ 115,127
Buildings	5,043,463	4,740,770
Improvements other than buildings	559,877	534,029
Equipment	1,100,431	1,032,923
Total plant	6,819,821	6,422,849
Less accumulated depreciation	(3,089,057)	(2,875,046)
Total investment in plant, net	$ 3,730,764	$ 3,547,803

The value of land, buildings, and equipment is recorded at cost or, if received as gifts, at fair value at date of gift. The University does not capitalize the cost of library books. Depreciation is computed over the estimated useful lives of the assets using the straight-line method. Useful lives range from 4 to 50 years for buildings, 10 to 20 years for improvements other than buildings, and 1 to 20 years for equipment. Depreciation expense was $251.4 million and $242.5 million for the fiscal years ended June 30, 2013 and 2012, respectively. The University has certain building and equipment lease agreements in effect which are considered capital leases that are included as long-term debt in the statements of financial position. These leases have been capitalized at the lower of fair market value or net present value of the minimum lease payments. Buildings and equipment held under capital leases are amortized on a straight-line basis over the shorter of the lease term or the estimated useful life of the asset. The capitalized cost and accumulated depreciation of the leases at June 30, 2013 and 2012 was $135.5 million and $41.8 million, and $108.3 million and $33.4 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)	2013	2012
Accounts payable (non-Medical Center)	$ 366,637	$ 246,127
Medical Center accounts payable and other accrued expenses	187,667	177,063
Accrued payroll and other related liabilities	87,300	82,211
Accrued bond interest	13,674	14,398
Student deposits	4,818	4,906
Total accounts payable and other accrued expenses	$ 660,096	$ 524,705

Asset Retirement Obligations

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

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

	(in thousands of dollars)
Balance as of June 30, 2011	$ 60,270
Accretion expense	5,430
Liabilities settled	(3,766)
Balance as of June 30, 2012	61,934
Accretion expense	7,651
Liabilities settled	(4,293)
Balance as of June 30, 2013	$ 65,292

Annuities Payable

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

Income Taxes

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

Reclassification

Certain 2012 amounts have been reclassified to conform with the 2013 presentation of the nonperiodic change in postretirement benefit plan as a nonoperating activity within the consolidated statement of activities.

	As previously presented	Updated presentation	Change
Operating expenses:			
Educational and general –			
Instruction	$ 1,234,581	$ 1,080,767	$ (153,814)
Research	777,752	756,608	(21,144)
Public service	101,683	87,212	(14,471)
Academic support	355,795	304,846	(50,949)
Student services	176,398	158,649	(17,749)
Institutional support	314,307	277,147	(37,160)
Total educational and general	$ 2,960,516	$ 2,665,229	$ (295,287)
Nonoperating expenses:			
Nonperiodic change in			
postretirement benefit plan	$ -	$ (295,287)	$ (295,287)

Recent Accounting Pronouncements

In September 2011, the FASB issued ASU 2011-08, *Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment,* which permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two step goodwill impairment test described in Topic 350. The guidance provided in this ASU is effective for annual tests performed for fiscal years beginning after December 15, 2011. The adoption of this standard on July 1, 2012 had no impact on financial condition, results of operations or cash flows.

In December 2011, the FASB issued ASU 2011-11, "*Disclosures About Offsetting Assets and Liabilities.*" This guidance contains new disclosure requirements regarding the nature of an entity's rights of setoff and related arrangements associated with its financial instruments and derivative instruments. This guidance is effective for the University beginning July 1, 2013 and retrospective application is required. The University does not expect this guidance to have an impact on its consolidated financial statements. In January 2013, the FASB issued ASU 2013-01, *"Clarifying the Scope of Disclosures About Offsetting Assets and Liabilities."* This guidance provides clarification on the scope of the offsetting disclosure requirements in ASU 2011-11. This guidance is effective for the University beginning July 1, 2013 with early adoption permitted. The University does not expect this guidance to have a material impact on its consolidated financial statements.

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

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

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

3. INVESTMENTS

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

(in thousands of dollars)	2013	2012
Money markets	$ 371,987	$ 251,782
Fixed income:		
U.S. government/agency	1,174,609	1,230,097
U.S. corporate	706,291	639,456
Foreign	372,515	219,852
Other	146,617	108,140
Equities	1,342,487	887,826
Private capital	902,728	714,397
Total	$ 5,017,234	$ 4,051,550

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

Futures contracts, which are fully cash collateralized, comprise the University's directly held derivative instruments at June 30, 2013 and 2012, respectively, are marked to market daily and are included in the fair value of the University's investments. The fair value of derivative instruments is included in the fair value of the University's investments within the money market category. Futures contracts have minimal credit risk because the counterparties are the exchanges themselves. Fully cash collateralized derivative securities comprised $270.5 Million, 5.4% of total investments, and $175.0 Million, 4.3% of total investments at June 30, 2013 and 2012, respectively. The University's derivatives consist of S&P 500 and Treasury futures and are employed as a low cost, passive investment vehicle with daily liquidity which allows the University to maintain desired market exposure in light of irregular cash flows.

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

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

(in thousands of dollars) 2012	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Dividends and interest	$ 97,015	$ 553	$ 5,125	$ 102,693
Net realized gains/(losses)	44,212	(12,172)	-	32,040
Net unrealized gains/(losses)	5,343	(15,623)	-	(10,280)
Total returns	$ 146,570	$ (27,242)	$ 5,125	$ 124,453

4. ENDOWMENT NET ASSETS

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

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

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

From time to time, due to unfavorable market fluctuations, the fair value of some assets associated with individual donor-restricted endowment funds may fall below the level that donors require to be retained as a perpetual fund, while other assets are unaffected to the same extent and maintain or exceed the level required. The aggregate amount of deficiencies at June 30, 2013 and 2012 was $2.5 million and $4.9 million, respectively, reported in unrestricted net assets on the consolidated statement of activities. Subsequent investment gains will be used to restore the balance up to the fair market value of the original gift. Subsequent gains above that amount will be recorded as temporarily restricted net assets.

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

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

(in thousands of dollars) 2012	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ (4,935)	$ 284,539	$ 1,001,580	$ 1,281,184
Funds functioning as endowments	491,737	-	-	491,737
Total net assets	$ 486,802	$ 284,539	$ 1,001,580	$ 1,772,921

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

(in thousands of dollars) 2013	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of the year	$ 486,802	$ 284,539	$ 1,001,580	$ 1,772,921
Endowment return:				
Endowment earnings	36,279	80	3,605	39,964
Net realized gains	35,180	21,351	-	56,531
Net unrealized gains	20,830	34,900	-	55,730
Reclassification of funds with deficiencies	2,405	(2,405)	-	-
Total endowment return	94,694	53,926	3,605	152,225
Contributions	-	505	61,896	62,401
Endowment spending	(71,459)	-	-	(71,459)
Transfers to create funds functioning as endowments	8,055	-	-	8,055
Endowment net assets, end of the year	$ 518,092	$ 338,970	$ 1,067,081	$ 1,924,143

(in thousands of dollars) 2012	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of the year	$ 472,068	$ 314,769	$ 951,006	$ 1,737,843
Endowment return:				
Endowment earnings	37,712	74	3,109	40,895
Net realized gains/(losses)	33,131	(12,229)	-	20,902
Net unrealized losses	(4,444)	(20,754)	-	(25,198)
Reclassification of funds with deficiencies	(1,674)	1,674	-	-
Total endowment return	64,725	(31,235)	3,109	36,599
Contributions	-	1,005	47,465	48,470
Endowment spending	(70,843)	-	-	(70,843)
Transfers to create funds functioning as endowments	20,852	-	-	20,852
Endowment net assets, end of the year	$ 486,802	$ 284,539	$ 1,001,580	$ 1,772,921

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 2013 and 2012) of its pooled endowment fund’s average fair market value over the prior five years preceding the fiscal year in which the distribution is planned. Accordingly, over the long term, the University expects the current spending policy to allow its endowment to provide generous current spending while preserving “intergenerational equity”. This is consistent with the University’s objective to maintain the purchasing power of the endowment assets held in perpetuity as well as to provide additional real growth through new gifts and investment returns.

5. FAIR VALUE MEASUREMENTS

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

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

Level 2 – Inputs other than unadjusted quoted prices that are observable for the asset or liability, directly or indirectly, including quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability, and inputs that are derived from observable market data by correlation or other means. Level 2 measures include University interests in certain debt instruments and commingled investment funds which NAV is used as a practical expedient. These funds are redeemable at NAV as of the measurement date, generally within 90 days.

Level 3 – Unobservable inputs that cannot be corroborated by observable market data. Level 3 instruments primarily consist of investment funds for which NAV is used as a practical expedient. The University does not have the ability to redeem the funds at NAV as of the measurement date.

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

The following table presents information as of June 30, 2013 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	$ 86,754	$ 261,667	$ -	$ 348,421
Fixed income				
U.S. government/agency	84,168	29,967	-	114,135
U.S. corporate	4,229	83,480	-	87,709
Foreign	60,260	174,985	-	235,245
Other	-	8,913	-	8,913
Equities	822,353	373,406	63,157	1,258,916
Private capital	-	307,741	588,922	896,663
Total	$ 1,057,764	$ 1,240,159	$ 652,079	$ 2,950,002
Operating investments:				
Money markets	$ 23,360	$ 206	$ -	$ 23,566
Fixed income				
U.S. government/agency	574,415	485,921	138	1,060,474
U.S. corporate	-	618,582	-	618,582
Foreign	-	137,270	-	137,270
Other	-	134,890	2,814	137,704
Equities	81,470	798	1,303	83,571
Private capital	-	-	6,065	6,065
Total	$ 679,245	$ 1,377,667	$ 10,320	$ 2,067,232
Deposits held by bond trustees:				
Fixed income				
U.S. government/agency	$ -	$ 2,551	-	$ 2,551
Total	$ -	$ 2,551	$ -	$ 2,551
Beneficial interest in perpetual trusts	$ -	$ -	$ 13,252	$ 13,252
Liabilities:				
Present value of annuities payable	$ -	$ -	$ 42,255	$ 42,255

The following table presents information as of June 30, 2012 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	$ -	$ 228,931	$ -	$ 228,931
Fixed income				
U.S. government/agency	108,848	11,700	-	120,548
U.S. corporate	4,263	84,240	-	88,503
Foreign	17,930	43,471	-	61,401
Other	-	7,465	-	7,465
Equities	600,109	208,043	-	808,152
Private capital	-	100,177	607,407	707,584
Total	$ 731,150	$ 684,027	$ 607,407	$ 2,022,584
Operating investments:				
Money markets	$ 22,635	$ 216	$ -	$ 22,851
Fixed income				
U.S. government/agency	607,895	501,529	125	1,109,549
U.S. corporate	9,661	541,292	-	550,953
Foreign	3,679	154,772	-	158,451
Other	-	98,207	2,468	100,675
Equities	77,435	867	1,372	79,674
Private capital	-	-	6,813	6,813
Total	$ 721,305	$ 1,296,883	$ 10,778	$ 2,028,966
Deposits held by bond trustees:				
Fixed income				
U.S. government/agency	$ -	$ 2,551	-	$ 2,551
Total	$ -	$ 2,551	$ -	$ 2,551
Beneficial interest in perpetual trusts	$ -	$ -	$ 12,891	$ 12,891
Liabilities:				
Present value of annuities payable	$ -	$ -	$ 43,167	$ 43,167

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, 2013 and 2012, fair value of endowment funds and funds functioning as endowments within the LTIP totaled $1,941.1 million and $1,780.6 million, respectively. At June 30, 2013 and 2012, fair value of operating funds included in the LTIP totaled $1,008.9 million and $242.0 million, respectively.

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

(in thousands of dollars)	Long-term Investment Pool	Operating Investments	Beneficial Interest in Perpetual Trusts
Assets:			
Beginning balance	$ 607,407	$ 10,778	$ 12,891
Total realized and unrealized gains	60,065	(388)	361
Purchases	165,678	75	-
Sales	(135,294)	(145)	-
Transfers into (out of) Level 3	(45,777)	-	-
Ending balance	$ 652,079	$ 10,320	$ 13,252

	Present Value of Annuities Payable
Liabilities:	
Beginning balance	$ 43,167
Actuarial adjustment of liability	4,679
Gifts	642
Sales	(6,233)
Withdrawal from program	-
Ending balance	$ 42,255

The following tables present information related to changes in Level 3 for each category of assets and liabilities for year ended June 30, 2012:

(in thousands of dollars)	Long-term Investment Pool	Operating Investments	Investments Held Under Securities Lending	Beneficial Interest in Perpetual Trusts
Assets:				
Beginning balance	$ 520,605	$ 9,245	$ 219,524	$ 12,843
Total realized and unrealized gains	22,361	1,150	-	48
Purchases	133,811	417	-	-
Sales	(69,370)	(36)	(219,524)	-
Transfers into Level 3	-	2	-	-
Ending balance	$ 607,407	$ 10,778	$ -	$ 12,891

	Present Value of Annuities Payable	Liability Under Securities Lending
Liabilities:		
Beginning balance	$ 44,425	$ 219,524
Actuarial adjustment of liability	(1,860)	-
Gifts	722	-
Sales	(120)	-
Withdrawal from program	-	(219,524)
Ending balance	$ 43,167	$ -

For the year ended June 30, 2013, $45.8 million of Level 3 assets were transferred to Level 2 as a result of the expiration of lock-up periods for two marketable alternative funds; now these investments may be redeemed within 90 days of June 30.

There were no transfers of investments between Level 1 and Level 2 in 2013 and 2012.

The following table presents the fair value and redemption frequency for those investments whose fair value is not readily determinable and is estimated using the net asset value per share or its equivalent as of June 30, 2013:

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

The following table presents the fair value and redemption frequency for those investments whose fair value is not readily determinable and is estimated using the net asset value per share or its equivalent as of June 30, 2012:

(in thousands of dollars)	Fair Value	Unfunded Commitment	Redemption Frequency	Redemption Notice Period
Commingled Funds:				
Non-U.S. Equity	$ 148,068		Daily/Monthly	5-15 days
Subtotal	$ 148,068			
Marketable Investment Partnerships:				
Absolute Return	$ 20,738		Quarterly	65 days
Private Debt/Distressed	60,101		Quarterly/ Semi Annual	60-90 days
Opportunistic	25,034		Quarterly	30 days
Directional Long/Short	69,324		Quarterly	30-90 days
Subtotal	$ 175,197			
Non-Marketable Investment Partnerships:				
Private Real Estate	$ 86,567	$ 22,407		
Venture Capital	129,354	92,911		
Private Equity	229,766	80,808		
Natural Resources	74,782	33,364		
Private Debt	12,656	15,700		
Subtotal	$ 533,125	$ 245,190		
Total	$ 856,390	$ 245,190		

Commingled funds include investments that aggregate assets from multiple investors and are managed collectively following a prescribed strategy. Redemptions vary from daily to quarterly with required notification of 90 days or less. The non-U.S. equity strategy is invested in developed and developing countries outside of the United States, and spans the entire equity capitalization spectrum. These collective portfolios preclude the need to obtain securities registration in foreign countries. During the last fiscal year, one commingled fund was added with a 3 year gate, approximately 17.4% of commingled.

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

Nonmarketable Investment Partnerships include limited partnership interests in a variety of illiquid investments. The fair values of the investments for each fund in this category have been estimated using the net asset value of the Endowment'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 Endowments drawdown funds as of June 30, 2013 and 2012, respectively. Five major investment strategies are included within this category. Private Real Estate includes properties primarily located in the U.S. Venture Capital includes non-public startups and enterprises in early stages of growth located globally. Private Equity includes buyouts of previously public companies as well as enterprises that are planning to go public in the near future, including funds focusing on opportunities outside the U.S. Natural Resources largely include companies primarily involved in oil and natural gas in addition to a variety of other natural resources. Private Debt includes global private credit securities rated below investment grade as well as non-rated debt.

6. CONTRIBUTIONS RECEIVABLE

Contributions receivable are summarized as follows as of June 30:

(in thousands of dollars)	2013	2012
In one year or less	$ 57,002	$ 75,753
Between one year and five years	63,742	53,998
More than five years	119,990	118,130
	240,734	247,881
Less allowance	(5,704)	(7,739)
Less discount	(56,893)	(55,729)
Contributions receivable, net	$ 178,137	$ 184,413

Contributions receivable are discounted at rates ranging from 0.15% to 2.87% and 0.21% to 2.06% at June 30, 2013 and 2012, respectively. The discount rates for prior periods ranged from 0.19% to 6.28%.

At June 30, 2013 and 2012, the University has received bequest intentions and certain other conditional promises to give of $85.8 million and $69.0 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, 2013:

	(in thousands of dollars)
Balance beginning of year	$ 184,413
New pledges	81,477
Collections on pledges	(88,624)
Decrease in allowance	2,035
Increase in unamortized discounts	(1,164)
Balance at the end of year	$ 178,137

7. LONG-TERM DEBT

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

(in thousands of dollars)	2013	2012
The Pennsylvania State University Bonds		
Series 2010	$ 135,035	$ 135,035
Series 2009A	114,075	120,075
Series 2009B	74,235	74,235
Series 2008A	77,670	77,670
Series 2008B	3,980	4,890
Series 2007A	88,125	88,645
Series 2007B	63,515	66,255
Series 2005	85,700	87,665
Series 2004A	52,835	54,135
Refunding Series 2003	-	15,890
Series of 2002	-	100,000
Refunding Series 2002	41,655	56,540
Pennsylvania Higher Educational Facilities Authority University Revenue Bonds (issued for The Pennsylvania State University)		
Series 2006	3,545	3,745
Series 2004	3,905	4,145
Series 2002	4,020	4,375
Lycoming County Authority College Revenue Bonds (issued for Penn College)		
Series 2012	24,685	24,685
Series 2011	39,050	39,050
Series 2008	55,000	55,000
Series 2005	11,085	12,020
Series 1993	5,250	7,000
Total bonds payable	883,365	1,031,055
Unamortized bond premiums	38,008	41,317
Capital lease obligations	84,035	80,334
Total long-term debt	$ 1,005,408	$ 1,152,706

Debt issuance	Interest rate mode	Interest rates	Payment ranges and maturity *(in thousands of dollars)*
The Pennsylvania State University Bonds			
Series 2010	Fixed	3.375% - 5.00%	$3,655 to $6,595 through March 2030 with $21,805 and $44,245 due March 2035 and 2040
Series 2009A	Fixed	4.00% - 5.00%	$6,235 to $9,320 through March 2029
Series 2009B	Variable	0.22%	June 2031
Series 2008A	Fixed	5.00%	$1,840 to $7,695 through August 2029
Series 2008B	Fixed	3.50% - 3.75%	$945 to $1,050 through August 2016
Series 2007A	Fixed	3.65% - 4.50%	$530 to $700 through August 2022, with $11,115 and $70,905 due August 2028 and 2036
Series 2007B	Fixed	5.00% - 5.25%	$2,885 to $5,955 through August 2027
Series 2005	Fixed	3.50% - 5.00%	$2,050 to $2,745 through September 2019 with $15,990, $20,550, and $32,485 due September 2024, 2029, and 2035
Series 2004A	Fixed	4.50% - 5.00%	$1,360 to $1,825 through September 2019, with $10,625, $13,635, and $17,515 due September 2024, 2029, and 2034
Refunding Series 2003	Fixed		Paid in full during May 2013
Series of 2002	Variable		Paid in full during December 2012
Refunding Series 2002	Fixed	5.25%	$4,585 to $16,540 through August 2016
Pennsylvania Higher Education Facilities Authority (“PHEFA”) University Revenue Bonds			
Series 2006	Fixed	4.00% - 5.125%*	$210 to $280 through 2020, with $1,610 due September 2025
Series 2004	Fixed	4.15% - 5.00%*	$250 to $325 through 2019, with $1,905 due September 2024
Series 2002	Fixed	4.30% - 5.00%*	$370 to $425 due through 2017, with $2,435 due March 2022

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

Lycoming County Authority College Revenue Bonds			
Series 2012	Fixed	2.00% - 5.00%	$410 to $2,635 through May 2032
Series 2011	Fixed	3.00% - 5.50%	$70 to $5,230 through July 2030
Series 2008	Fixed	3.50% - 5.50%	$1,455 to $4,140 through October 2037
Series 2005	Fixed	4.00% - 5.00%	$505 to $1,855 through January 2025
Series 1993	Fixed	6.10% - 6.15%	$450 to $513 through November 2015

The Series 2009B Bonds are currently paying interest on a variable rate basis at a long term rate for the period June 1, 2013 through May 31, 2014. The University has the option to convert to another variable rate (daily, weekly, monthly or flexible) or to a fixed rate basis (such rates are generally determined on a market basis) at respective conversion dates. The bonds currently pay interest at 0.22% with adjustment on the respective date to the rate the remarketing agent believes will cause the bonds to have a market value equal to the principal. The 2009B bondholders have the right to tender bonds on the purchase dates while such bonds bear interest at the daily, weekly or monthly rate. The 2009B Bonds were issued subject to the self-liquidity program established by the University on the date of issuance pursuant to which the University will provide liquidity for the 2009B Bonds from its general funds in the event of insufficient remarketing proceeds.

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

Year	Annual Installments *(in thousands of dollars)*
2014	$ 33,305
2015	35,330
2016	24,320
2017	28,780
2018	24,455
Thereafter	737,175
	$ 883,365

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, 2013, the carrying value and estimated fair value of the University's bonds payable, including issuance premiums, are $921.4 million and $939.4 million, respectively. At June 30, 2012, the carrying value and estimated fair value of the University's bonds payable, including issuance premiums, were $1,072.4 million and $1,118.5 million, respectively. Certain bond issues have associated issuance premiums, these issuance premiums total $38.0 million and $41.3 million at June 30, 2013 and 2012, 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.

Capital leases

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, 2013 are as follows:

Year	*(in thousands of dollars)*
2014	$ 13,188
2015	12,018
2016	11,033
2017	10,194
2018	8,819
Thereafter	140,557
Total minimum lease payments	195,809
Less imputed interest	(111,774)
Capital lease obligation	84,035
Current portion	7,763
Long-term portion	$ 76,272

8. OPERATING LEASES

The University has certain lease agreements in effect which are considered operating leases. During the year ended June 30, 2013, the University recorded expenses of $22.0 million for leased equipment and $22.6 million for leased building space. During the year ended June 30, 2012, the University recorded expenses of $19.0 million for leased equipment and $23.6 million for leased building space.

Future minimum lease payments under operating leases as of June 30, 2013 are as follows:

Year	*(in thousands of dollars)*
2014	$ 20,111
2015	17,333
2016	14,086
2017	11,118
2018	8,486
Thereafter	41,328
Total minimum lease payments	$ 112,462

9. RETIREMENT BENEFITS

The University provides retirement benefits for substantially all regular employees, primarily through either contributory defined benefit plans administered by the Commonwealth of Pennsylvania State Employees' Retirement System and The Public School Employees' Retirement System or defined contribution plans administered by the Teachers Insurance and Annuity Association – College Retirement Equity Fund and Fidelity Investments. The University is billed for its share of the estimated actuarial cost of the defined benefit plans ($35.9 million and $25.1 million for the years ended June 30, 2013 and 2012, respectively). The University's total cost for retirement benefits, included in expenses, is $146.6 million and $130.9 million for the years ended June 30, 2013 and 2012, respectively.

10. POSTRETIREMENT BENEFITS

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

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

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

The retiree PPO medical plan and the life insurance coverage are self-funded programs, and all medical claims, death benefits and other expenses are paid from the unrestricted net assets of the University. The Medicare Advantage PPO plan and the Medicare Supplement plan are fully insured. The retirees pay varying amounts for coverage under the medical plan.

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

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

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

Included in unrestricted net assets at June 30, 2013 and 2012 are the following amounts that have not yet been recognized in net periodic postretirement cost: unrecognized prior service cost (benefit) of ($86.3) million and ($108.0) million and unrecognized actuarial loss of $547.6 million and $852.7 million, respectively.

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

Change in benefit obligation:
(in thousands of dollars)

	2013	2012
Benefit obligation at beginning of year	$ 1,864,899	$ 1,479,043
Service cost	56,194	45,124
Interest cost	77,943	80,779
Actuarial gain	(95,754)	(15,784)
Benefits paid	(43,840)	(42,813)
Plan assumptions	(164,401)	318,550
Benefit obligation at end of year	$ 1,695,041	$ 1,864,899

Change in plan assets:
(in thousands of dollars)

	2013	2012
Fair value of plan assets at beginning of year	$ -	$ -
Employer contributions	43,840	42,813
Benefits paid	(43,840)	(42,813)
Fair value of plan assets at end of year	$ -	$ -
Funded status	$ (1,695,041)	$ (1,864,899)
Unrecognized prior service cost (benefit)	-	-
Unrecognized net actuarial loss	-	-
Accrued postretirement benefit expense	$ (1,695,041)	$ (1,864,899)

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

	2013	2012
Service cost	$ 56,194	$ 45,124
Interest cost	77,943	80,779
Amortization of prior service cost	(21,699)	(21,699)
Amortization of unrecognized net loss	44,960	29,178
Net periodic postretirement cost	$ 157,398	$ 133,382

The assumed healthcare cost trend rate used in measuring the accumulated postretirement benefit obligation was 8.00% and 8.50% for the years ended June 30, 2013 and 2012, respectively, reduced by 0.50% per year to a fixed level of 5.00%. The weighted average postretirement benefit obligation discount rate was 5.00% and 4.50% for the years ended June 30, 2013 and 2012, respectively.

If the healthcare cost trend rate assumptions were increased by 1% in each year, the accumulated postretirement benefit obligation would be increased by $318.1 million and $595.2 million as of June 30, 2013 and 2012, 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 $32.3 million and $42.2 million as of June 30, 2013 and 2012, respectively. If the healthcare cost trend rate assumptions were decreased by 1% in each year, the accumulated postretirement benefit obligation would be decreased by $256.6 million and $327.0 million as of June 30, 2013 and 2012, 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 $24.5 million and $23.1 million as of June 30, 2013 and 2012, 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)
2014	$ 51,390
2015	55,312
2016	59,517
2017	63,945
2018	68,198
2019-23	408,966

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

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

The Health System is a corporate investor in healthcare joint ventures, which are supportive of the missions of the Medical Center. The Health System was organized in 1995 as a wholly-owned subsidiary of the Corporation for the purpose of organizing components of an integrated health care delivery system. The Health System recorded non-controlling interest related to the acquisition of additional ownership interest in a joint venture. This noncontrolling interest is recorded in the net assets within the consolidated statements of financial position with a value at June 30, 2013 and 2012 of $831,000 and $774,000, respectively.

12. CONTINGENCIES AND COMMITMENTS

Contractual Obligations

The University has contractual obligations for the construction of new buildings and for additions to existing buildings in the amount of $775.1 million of which $651.4 million has been paid or accrued as of June 30, 2013. 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 $20.5 million and $18.2 million as of June 30, 2013 and 2012, respectively. These letters of credit are used primarily to comply with minimum state and federal regulatory laws that govern various University activities. The fair value of these letters of credit approximates contract values based on the nature of the fee arrangements with the issuing banks.

Guarantees

The University has a contract with a third party whereby the third party acts as an agent of the University in connection with procurement of electricity. The University guarantees the payment of the obligations of the third party incurred on behalf of the University to counterparties. No liabilities related to guarantees have been recorded as of June 30, 2013.

<u>Self-Insurance</u>

The University has a coordinated program of commercial and self-insurance for medical malpractice claims at TMSHMC through the use of a qualified trust and a domestic captive insurance company in combination with a self-insured retention layer and is supplementing this program through participation in the Pennsylvania Medical Care Availability and Reduction of Error Fund ("Mcare Fund"), in accordance with Pennsylvania law. An estimate of the present value, discounted at 2% for the years ended June 30, 2013 and 2012, respectively, of the medical malpractice claims liability in the amount of $96.7 million and $101.1 million is recorded as of June 30, 2013 and 2012, respectively.

On July 1, 2003, TMSHMC became self-insured for all medical malpractice claims asserted on or after July 1, 2003, for all amounts that are below the coverage of the TMSHMC's excess insurance policies and not included in the insurance coverage of the Mcare Fund. Under the self-insurance program, TMSHMC is required to maintain a malpractice trust fund in an amount at least equal to the expected loss of known claims. The balance of this trust fund was $20.7 million and $21.3 million at June 30, 2013 and 2012, respectively. TMSHMC intends to fund any claims due during the next year from cash flows from operations.

With approval from the Pennsylvania Department of Labor and Industry ("PA-DLI"), the University elected to self-insure potential obligations applicable to workers' compensation. Certain claims under the program are contractually administered by a private agency. The University purchased insurance coverage for excess obligations over $600,000 per incident. An estimate of the self-insured workers' compensation claims liability in the amount of $10.9 million and $12.4 million, discounted at 1.25%, is recorded as of June 30, 2013 and 2012, respectively. The University has established a trust fund, in the amount of $12.7 million at June 30, 2013 and 2012, respectively, as required by PA-DLI, to provide for the payment of claims under this self-insurance program. TMSHMC is self-insured for workers' compensation claims and has purchased an excess policy through a commercial insurer which covers individual claims in excess of $500,000 per incident for workers' compensation claims.

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

<u>Litigation and Contingencies</u>

In November 2011, the University was made aware of certain allegations in a Commonwealth of Pennsylvania Grand Jury presentment. Various legal proceedings and investigations have arisen as a result of such allegations, including criminal proceedings against former officers and employees of the University. Certain claims and civil litigation have been filed against the University with anticipation that other complaints could be filed. At June 30, 2013, the University has accrued $59.7 million for 26 of 32 known claims, 24 of which have been settled subsequent to June 30, 2013. Such costs are included in institutional support within the consolidated statement of activities. Of the remaining six claims, two have been deemed to have no merit through the due diligence process. Without having knowledge of the number and nature of unknown claims and in view of the inherent difficulty of predicting the outcome of our remaining four known claims, each with their own unique circumstances that give rise to their alleged claims, and given the various stages of the proceedings, we are unable to predict the outcome of these matters or the ultimate legal and financial liability, and at this time cannot reasonably estimate the possible loss or range of loss. Accordingly, no amounts have been accrued in the 2013 financial statements for these claims although a loss is reasonably possible in future periods which could have a material adverse effect on our current and future financial position, results of operations and cash flows.

For the years ended June 30, 2013 and 2012, the University has incurred costs, net of insurance reimbursements totaling $17.3 and $16.1 million, respectively, for internal investigation, legal, communications and other related costs. These costs are included in institutional support within the consolidated statement of activities. Insurance reimbursements for the years ended June 30, 2013 and 2012 totaled $249,000 and $153,000, respectively. Amounts paid directly by insurance carriers for the years ended June 30, 2013 and 2012 totaled $2,994,000 and $626,000, respectively.

The University has submitted claims to insurance carriers at June 30, 2013 related to the claims settled and certain legal costs incurred to date. Amounts of future insurance reimbursement are unknown as of June 30, 2013 and as a result no insurance recovery accruals have been recorded in the 2013 financial statements.

Based on its operation of the Medical Center (see Note 11), the University, like the rest of the healthcare industry, is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations can be subject to government review and interpretation, as well as regulatory actions. Recently, government reviews of healthcare providers for compliance with regulations have increased. Although the University believes it has done its best to comply with these numerous regulations, such government reviews could result in significant repayments of previously billed and collected revenues from patient services.

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

13. SUBSEQUENT EVENTS

The University has evaluated subsequent events through November 1, 2013, 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.

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

THE PENNSYLVANIA STATE UNIVERSITY

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VIRTUE LIBERTY AND INDEPENDENCE