



PennState

Audited Financial Statements

The Pennsylvania State University
Fiscal Year Ended June 30, 2018

THE PENNSYLVANIA STATE UNIVERSITY

UNIVERSITY OFFICERS

as of October 23, 2018

ERIC J. BARRON

President

STEPHEN S. DUNHAM

Vice President and General Counsel

DAVID J. GRAY

Senior Vice President for
Finance and Business/Treasurer

A. CRAIG HILLEMEIER

Dean, Penn State College of Medicine;
Chief Executive Officer, Penn State Health; and
Senior Vice President for Health Affairs,
Penn State University

NICHOLAS P. JONES

Executive Vice President
and Provost

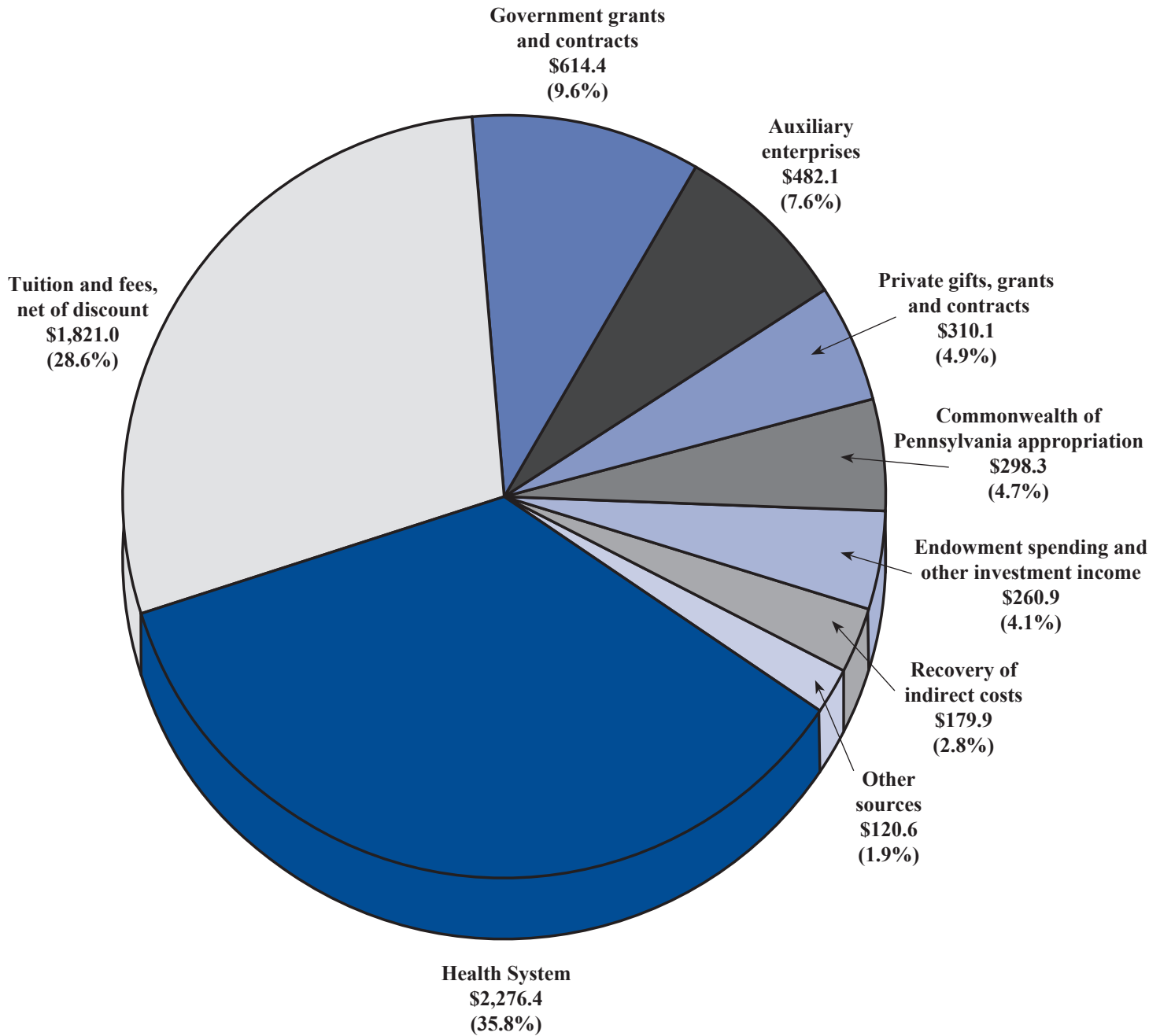
CONTENTS

Operating Revenues by Source	2
Operating Expenses by Function	3
Letter of Transmittal	5
Independent Auditors' Report	7
Consolidated Financial Statements:	
Statements of Financial Position	8
Statements of Activities	10
Statements of Cash Flows	12
Notes to Consolidated Financial Statements	13

OPERATING REVENUES BY SOURCE (\$6.4 billion)

For the Year Ended June 30, 2018

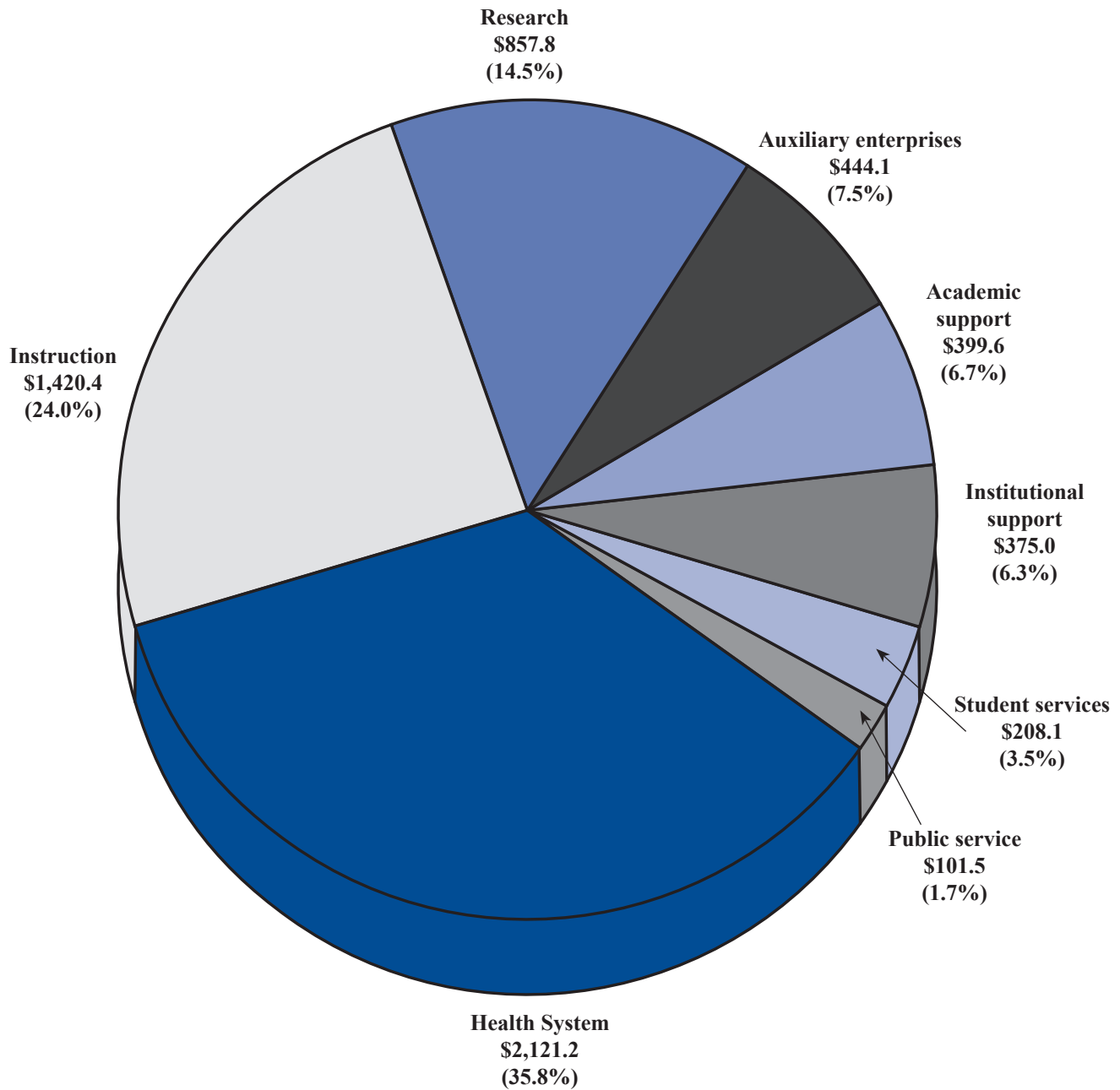
(\$ in millions)



OPERATING EXPENSES BY FUNCTION (\$5.9 billion)

For the Year Ended June 30, 2018

(\$ in millions)







The Pennsylvania State University
408 Old Main
University Park, PA 16802-1505
(814) 865-1355
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Office of the Corporate Controller

October 23, 2018

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, 2018 and 2017 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

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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, 2018 and 2017, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

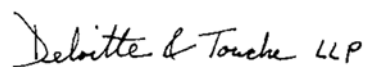
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the University as of June 30, 2018 and 2017, 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.



October 23, 2018

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
ASSETS
JUNE 30, 2018 AND 2017
(in thousands)

	<u>June 30, 2018</u>	<u>June 30, 2017</u>
Current assets:		
Cash and cash equivalents	\$ 2,089,105	\$ 1,761,703
Short-term investments	331,421	325,758
Deposits held by bond trustees	87,459	138,954
Deposits held for others	36,845	37,031
Accounts receivable, net of allowances of \$84,647 and \$88,731	568,924	542,603
Contributions receivable, net	62,318	60,893
Loans to students, net of allowances of \$639 and \$570	9,352	9,461
Inventories	48,721	48,152
Prepaid expenses and other assets	<u>109,481</u>	<u>105,807</u>
Total current assets	<u>3,343,626</u>	<u>3,030,362</u>
Noncurrent assets:		
Deposits held by bond trustees	15,200	40,000
Contributions receivable, net	134,167	140,165
Loans to students, net of allowances of \$2,804 and \$2,548	50,015	49,121
Total investment in plant, net	5,248,322	4,921,412
Beneficial interest in perpetual trusts	23,587	19,854
Investments	6,065,540	5,716,986
Other assets	<u>136,815</u>	<u>112,391</u>
Total noncurrent assets	<u>11,673,646</u>	<u>10,999,929</u>
Total assets	<u><u>\$15,017,272</u></u>	<u><u>\$14,030,291</u></u>

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
LIABILITIES AND NET ASSETS
JUNE 30, 2018 AND 2017
(in thousands)

	<u>June 30, 2018</u>	<u>June 30, 2017</u>
Current liabilities:		
Accounts payable and other accrued expenses	\$ 712,590	\$ 689,885
Deferred revenue	358,004	341,261
Long-term debt	57,164	49,432
Present value of annuities payable	6,781	6,574
Accrued postretirement benefits	<u>61,286</u>	<u>56,466</u>
Total current liabilities	<u>1,195,825</u>	<u>1,143,618</u>
Noncurrent liabilities:		
Deposits held in custody for others	28,031	32,724
Deferred revenue	783	1,218
Long-term debt	1,393,013	1,419,961
Present value of annuities payable	52,455	51,496
Accrued postretirement benefits	2,132,269	2,261,996
Refundable United States Government student loans	46,708	46,713
Other liabilities	<u>243,794</u>	<u>230,067</u>
Total noncurrent liabilities	<u>3,897,053</u>	<u>4,044,175</u>
Total liabilities	<u>5,092,878</u>	<u>5,187,793</u>
Net assets:		
Unrestricted -		
Undesignated	1,743	1,692
Designated for specific purposes	3,878,698	3,350,691
Net investment in plant	<u>3,316,763</u>	<u>3,169,239</u>
Total unrestricted - The Pennsylvania State University	<u>7,197,204</u>	<u>6,521,622</u>
Noncontrolling interest	<u>223,647</u>	<u>4,609</u>
Total unrestricted	7,420,851	6,526,231
Temporarily restricted	784,883	708,103
Permanently restricted	<u>1,718,660</u>	<u>1,608,164</u>
Total net assets	<u>9,924,394</u>	<u>8,842,498</u>
Total liabilities and net assets	<u>\$15,017,272</u>	<u>\$14,030,291</u>

See notes to consolidated financial statements.

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating revenues and other support:				
Tuition and fees, net of discounts of \$214,774	\$ 1,820,971	\$ -	\$ -	\$ 1,820,971
Commonwealth of Pennsylvania -				
Appropriations	298,312	-	-	298,312
Special contracts	70,800	-	-	70,800
Department of General Services projects	47,809	-	-	47,809
United States Government grants and contracts	495,851	-	-	495,851
Private grants and contracts	222,350	-	-	222,350
Gifts and pledges	75,367	12,433	-	87,800
Endowment spending	105,183	-	-	105,183
Other investment income	154,092	1,598	-	155,690
Sales and services of educational activities	100,992	-	-	100,992
Recovery of indirect costs	179,879	-	-	179,879
Auxiliary enterprises	482,089	-	-	482,089
Health System revenue, net of provision for bad debts of \$50,660	2,276,366	-	-	2,276,366
Other sources	19,648	-	-	19,648
Net assets released from restrictions	4,318	(4,318)	-	-
Total operating revenues and other support	6,354,027	9,713	-	6,363,740
Operating expenses:				
Educational and general -				
Instruction	1,420,364	-	-	1,420,364
Research	857,786	-	-	857,786
Public service	101,470	-	-	101,470
Academic support	399,597	-	-	399,597
Student services	208,112	-	-	208,112
Institutional support	375,025	-	-	375,025
Total educational and general	3,362,354	-	-	3,362,354
Auxiliary enterprises	444,125	-	-	444,125
Health System expense	2,121,177	-	-	2,121,177
Total operating expenses	5,927,656	-	-	5,927,656
Increase in net assets from operating activities	426,371	9,713	-	436,084
Nonoperating activities:				
Gifts and pledges	-	-	99,039	99,039
Current year investment returns	94,495	69,206	13,543	177,244
Endowment appreciation utilized	(73,903)	-	-	(73,903)
Changes in funds held by others in perpetuity	-	-	3,732	3,732
Write-offs and disposals of assets	(14,887)	-	-	(14,887)
Nonperiodic change in postretirement benefit plan	243,506	-	-	243,506
Actuarial adjustment on annuities payable	-	(2,139)	(5,818)	(7,957)
Increase in net assets from nonoperating activities	249,211	67,067	110,496	426,774
Increase in net assets - The Pennsylvania State University	675,582	76,780	110,496	862,858
Noncontrolling interest:				
Capital contributions - Health System	200,000	-	-	200,000
Excess of revenues over expenses	19,038	-	-	19,038
Increase in net assets - noncontrolling interest	219,038	-	-	219,038
Increase in total net assets	894,620	76,780	110,496	1,081,896
Net assets at the beginning of the year	6,526,231	708,103	1,608,164	8,842,498
Net assets at the end of the year	\$ 7,420,851	\$ 784,883	\$ 1,718,660	\$ 9,924,394

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2017
(in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating revenues and other support:				
Tuition and fees, net of discounts of \$205,002	\$ 1,786,430	\$ -	\$ -	\$ 1,786,430
Commonwealth of Pennsylvania -				
Appropriations	296,764	-	-	296,764
Special contracts	68,933	-	-	68,933
Department of General Services projects	47,500	-	-	47,500
United States Government grants and contracts	479,717	-	-	479,717
Private grants and contracts	216,596	-	-	216,596
Gifts and pledges	62,906	24,631	-	87,537
Endowment spending	98,521	-	-	98,521
Other investment income	140,235	1,046	-	141,281
Sales and services of educational activities	84,508	-	-	84,508
Recovery of indirect costs	171,442	-	-	171,442
Auxiliary enterprises	465,716	-	-	465,716
Health System revenue, net of provision for bad debts of \$46,251	2,073,496	-	-	2,073,496
Other sources	40,628	-	-	40,628
Net assets released from restrictions	2,859	(2,859)	-	-
Total operating revenues and other support	6,036,251	22,818	-	6,059,069
Operating expenses:				
Educational and general -				
Instruction	1,402,451	-	-	1,402,451
Research	810,985	-	-	810,985
Public service	100,573	-	-	100,573
Academic support	404,098	-	-	404,098
Student services	204,943	-	-	204,943
Institutional support	400,646	-	-	400,646
Total educational and general	3,323,696	-	-	3,323,696
Auxiliary enterprises	426,204	-	-	426,204
Health System expense	1,927,155	-	-	1,927,155
Total operating expenses	5,677,055	-	-	5,677,055
Increase in net assets from operating activities	359,196	22,818	-	382,014
Nonoperating activities:				
Gifts and pledges	-	-	83,529	83,529
Current year investment returns	160,882	136,561	9,056	306,499
Endowment appreciation utilized	(75,871)	-	-	(75,871)
Changes in funds held by others in perpetuity	-	-	5,204	5,204
Write-offs and disposals of assets	(4,815)	-	-	(4,815)
Nonperiodic change in postretirement benefit plan	(51,116)	-	-	(51,116)
Actuarial adjustment on annuities payable	-	(2,349)	(8,463)	(10,812)
Increase in net assets from nonoperating activities	29,080	134,212	89,326	252,618
Increase in net assets - The Pennsylvania State University	388,276	157,030	89,326	634,632
Noncontrolling interest:				
Excess of revenues over expenses	922	-	-	922
Increase in net assets - noncontrolling interest	922	-	-	922
Increase in total net assets	389,198	157,030	89,326	635,554
Net assets at the beginning of the year	6,137,033	551,073	1,518,838	8,206,944
Net assets at the end of the year	\$ 6,526,231	\$ 708,103	\$ 1,608,164	\$ 8,842,498

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2018 AND 2017
(in thousands)

	<u>June 30, 2018</u>	<u>June 30, 2017</u>
Cash flows from operating activities:		
Increase in net assets	\$ 1,081,896	\$ 635,554
Adjustments to reconcile change in net assets to net cash provided by operating activities -		
Actuarial adjustment on annuities payable	7,957	10,812
Contributions restricted for long-term investment	(93,274)	(98,202)
Interest and dividends restricted for long-term investment	(89,759)	(78,598)
Net realized and unrealized (gains) losses on long-term investments	(258,722)	(408,457)
Capital contributions - Health System	(200,000)	-
Depreciation expense	371,570	350,531
Amortization expense	(194)	(52)
Loss on early extinguishment of debt	-	3,688
Write-offs and disposals of assets	15,905	5,126
Contributions of land, buildings and equipment	(6,625)	(2,960)
Contribution to government student loan funds	-	154
Provision for bad debts	62,616	63,136
Decrease (increase) in deposits held for others	186	(26,792)
Increase in receivables	(121,554)	(95,725)
Increase in inventories	(622)	(5,679)
Increase in prepaid expenses and other assets	(41,911)	(954)
(Decrease) increase in accounts payable and other accrued expenses	(7,423)	118,800
Increase in deferred revenue	16,309	26,319
(Decrease) increase in accrued postretirement benefits	(124,909)	169,939
Net cash provided by operating activities	<u>611,446</u>	<u>666,640</u>
Cash flows from investing activities:		
Purchase of land, buildings and equipment	(681,899)	(647,429)
Decrease (increase) in deposits held by bond trustees	76,295	(47,867)
Advances on student loans	(10,121)	(10,652)
Collections on student loans	8,490	10,900
Proceeds from sale of donated financial assets	-	236
Purchase of investments	(3,184,549)	(3,761,462)
Proceeds from sale of investments	3,156,165	3,720,543
Net cash used in investing activities	<u>(635,619)</u>	<u>(735,731)</u>
Cash flows from financing activities:		
Contributions restricted for long-term investment	93,274	98,202
Interest and dividends restricted for long-term investment	89,759	78,598
Capital contributions - Health System	200,000	-
Payments of annuity obligations	(6,810)	(6,602)
Proceeds from long-term debt	74,607	368,213
Principal payments on long-term debt	(99,675)	(103,303)
Proceeds related to government student loan funds, net of collection costs	420	172
Net cash provided by financing activities	<u>351,575</u>	<u>435,280</u>
Net increase in cash and cash equivalents	327,402	366,189
Cash and cash equivalents at the beginning of the year	<u>1,761,703</u>	<u>1,395,514</u>
Cash and cash equivalents at the end of the year	<u>\$ 2,089,105</u>	<u>\$ 1,761,703</u>

Supplemental disclosures of cash flow information (Note 2)

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2018 AND 2017

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, and the financial statements of The Corporation for Penn State and its subsidiaries (“the Corporation”). See Note 11 for additional information about 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 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 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.

The Health System has agreements with third-party payors that provide for payments to its subsidiaries at amounts different from their established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. In addition, net patient service revenue is net of provision for bad debts of \$50.7 million and \$46.3 million for the years ended June 30, 2018 and 2017, respectively. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined or such estimates change.

The subsidiaries of the Health System provide care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. The Health System does not pursue collection of amounts determined to qualify as charity care; these amounts are not reported as net patient service revenue. The amounts of direct and indirect costs for services and supplies furnished under the Health System's charity care policy totaled approximately \$26.0 million and \$27.4 million for the years ended June 30, 2018 and 2017, 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 \$53.2 million during 2018 and 2017, respectively.

Fair Value of Financial Instruments

The University has provided fair value estimates for certain financial instruments. Fair value information presented in the financial statements is based on information available at June 30, 2018 and 2017. 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, 2018 and 2017 have been made at the rates available to students for similar loans at such times. Investments are reported at fair value as disclosed in Note 3. The fair value of the University's bonds payable is disclosed in Note 7. See Note 5 for further discussion of fair value measurements.

Cash Flows

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

<i>(in thousands of dollars)</i>	<u>2018</u>	<u>2017</u>
Interest paid	\$ 51,533	\$ 42,826
Non-cash acquisitions of land, buildings and equipment	12,426	33,010

Capitalized costs accrued related to construction are \$88.7 million and \$73.6 million as of June 30, 2018 and 2017, respectively. Taxes paid for 2018 and 2017 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:

<i>(in thousands of dollars)</i>	<u>2018</u>	<u>2017</u>
Grants and contracts, net of allowance of \$2,267 and \$2,214	\$ 181,641	\$ 187,903
Patient accounts receivable, net of allowance of \$61,634 and \$61,448	250,789	197,613
Student receivables, net of allowance of \$13,840 and \$18,500	49,102	54,162
Investment and interest receivable	7,990	47,197
Other, net of allowance of \$6,906 and \$6,569	79,402	55,728
Total accounts receivable, net	<u>\$ 568,924</u>	<u>\$ 542,603</u>

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

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

Loans to Students

Loans to students are disbursed to qualified students based on need and include loans granted by the University from institutional resources and under federal government loan programs. Students 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, 2018 and 2017, student loans represent 0.4% of total assets, respectively.

The availability of funds for loans under federal government revolving loan programs is dependent on reimbursements to the pool from repayments of outstanding loans. Funds advanced by the federal government of \$46.7 million at June 30, 2018 and 2017, 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.

Loans to students consisted of the following at June 30:

<i>(in thousands of dollars)</i>	<u>2018</u>	<u>2017</u>
Loans to students:		
Federal government loan programs:		
Perkins loan program	\$ 42,720	\$ 42,772
Health Professions Student Loans and Loans for Disadvantaged Students	<u>20</u>	<u>39</u>
Federal government loan programs	42,740	42,811
Institutional loan programs	<u>20,070</u>	<u>18,889</u>
	62,810	61,700
Less allowance for doubtful accounts:		
Balance, beginning of year	(3,118)	(2,526)
Provision for doubtful accounts	<u>(325)</u>	<u>(592)</u>
Balance, end of year	<u>(3,443)</u>	<u>(3,118)</u>
Loans to students, net	<u>\$ 59,367</u>	<u>\$ 58,582</u>

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

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

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

	<i>(in thousands of dollars)</i>				
	<u>45 days or less</u>	<u>46-75 days</u>	<u>76-105 days</u>	<u>Over 105 days</u>	<u>Total</u>
<u>2017</u>					
Loans to students:					
Federal government loan programs	\$ 36,638	\$ 31	\$ 37	\$ 6,105	\$ 42,811
Institutional loan programs	<u>16,056</u>	<u>21</u>	<u>16</u>	<u>2,796</u>	<u>18,889</u>
Total loans to students	<u>52,694</u>	<u>52</u>	<u>53</u>	<u>8,901</u>	<u>61,700</u>
Allowance for doubtful accounts:					
Federal government loan programs					(457)
Institutional loan programs					<u>(2,661)</u>
Total allowance for doubtful accounts					<u>(3,118)</u>
Total loans to students, net					<u>\$ 58,582</u>

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, 2018 and 2017. Because the limited partnerships are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market existed, and such differences could be material.

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

Beneficial Interest in Perpetual Trusts

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

Investment in Plant

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

<i>(in thousands of dollars)</i>	<u>2018</u>	<u>2017</u>
Land	\$ 149,603	\$ 134,153
Buildings	7,218,469	6,771,677
Improvements other than buildings	706,585	678,049
Equipment	<u>1,612,938</u>	<u>1,497,053</u>
Total plant	9,687,595	9,080,932
Less accumulated depreciation	<u>(4,439,273)</u>	<u>(4,159,520)</u>
Total investment in plant, net	<u>\$ 5,248,322</u>	<u>\$ 4,921,412</u>

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 \$371.6 million and \$350.5 million for the fiscal years ended June 30, 2018 and 2017, 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, 2018 and 2017 were \$131.2 million and \$68.6 million, and \$188.0 million and \$85.4 million, respectively.

Accounts Payable and Other Accrued Expenses

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

<i>(in thousands of dollars)</i>	<u>2018</u>	<u>2017</u>
Accounts payable (non-Health System)	\$ 299,611	\$ 265,025
Health System accounts payable and other accrued expenses	283,700	262,722
Accrued payroll and other related liabilities	108,782	143,546
Accrued bond interest	17,594	15,705
Student deposits	<u>2,903</u>	<u>2,887</u>
Total accounts payable and other accrued expenses	<u>\$ 712,590</u>	<u>\$ 689,885</u>

Impairment of Long-Lived Assets

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

Asset Retirement Obligations

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:

	<i>(in thousands of dollars)</i>
Balance as of June 30, 2016	\$ 74,102
Adjustment to liability	12,892
Accretion expense	3,164
Liabilities settled	<u>(6,945)</u>
Balance as of June 30, 2017	83,213
Adjustment to liability	2,855
Accretion expense	3,577
Liabilities settled	<u>(8,414)</u>
Balance as of June 30, 2018	<u>\$ 81,231</u>

Annuities Payable

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

Net Assets

Net assets consist of the following at June 30:

<i>(in thousands of dollars)</i>	<u>2018</u>	<u>2017</u>
Unrestricted net assets	\$ 7,420,851	\$ 6,526,231
Temporarily restricted net assets:		
Future contributions	\$ 152,409	\$ 146,180
Annuity and life income funds	30,082	32,070
Contributions for property, plant and equipment	10,850	6,278
Term endowments and accumulated endowment gains	<u>591,542</u>	<u>523,575</u>
Total temporarily restricted net assets	<u>\$ 784,883</u>	<u>\$ 708,103</u>
Permanently restricted net assets:		
Future contributions	\$ 104,219	\$ 89,734
Annuity and life income funds	38,331	36,069
Student loan funds	17,310	16,890
Perpetual trusts and other funds	32,268	28,013
Endowment funds	<u>1,526,532</u>	<u>1,437,458</u>
Total permanently restricted net assets	<u>\$ 1,718,660</u>	<u>\$ 1,608,164</u>
Total net assets	<u>\$ 9,924,394</u>	<u>\$ 8,842,498</u>

Income Taxes

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

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers." This update clarifies the principles for recognizing revenue that (1) removes inconsistencies and weaknesses in revenue requirements, (2) provides a more robust framework for addressing revenue issues, (3) improves comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets, (4) provides more useful information to users of financial statements through improved disclosure requirements, and (5) simplifies the preparation of financial statements by reducing the number of requirements to which an entity must refer. In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers; Deferral of the Effective Date." This update defers the effective date of the original ASU. The update is now effective for the University beginning July 1, 2018. The University is currently in the process of analyzing this guidance, and believes that any impact to the consolidated financial statements will be immaterial.

In July 2015, the FASB issued ASU 2015-11, "Inventory; Simplifying the Measurement of Inventory." This update requires entities to measure inventory within the scope of the update at the lower of cost and net realizable value and was effective for the University beginning July 1, 2017. The adoption of this guidance did not have a material impact on the consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – Overall; Recognition and Measurement of Financial Assets and Financial Liabilities." This guidance addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. This guidance is effective for the University beginning July 1, 2018. The University has not yet evaluated the impact this guidance may have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases." This update requires substantial changes to lease accounting to increase transparency and comparability among organizations by recognizing lease

assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The main difference between previous GAAP and this guidance is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating under previous GAAP. This update is effective for the University beginning July 1, 2019 with early adoption permitted. The University has not yet evaluated the impact this guidance may have on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *“Not-for-Profit Entities; Presentation of Financial Statements of Not-for-Profit Entities.”* This update amends the requirements for financial statements and notes in Topic 958, Not-for-Profit Entities. The most significant amendment requires a not-for-profit entity (“NFP”) to present on the face of the statement of financial position amounts for two classes of net assets at the end of the period, rather than for the currently required three classes. That is, an NFP will report amounts for *net assets with donor restrictions* and *net assets without donor restrictions*, as well as the currently required amount for total net assets. This update is effective for the University beginning July 1, 2018 with early adoption permitted. The University has not yet evaluated the impact this guidance may have on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *“Statement of Cash Flows; Classification of Certain Cash Receipts and Cash Payments.”* This update provides guidance on eight specific cash flows issues with the objective of reducing the existing diversity in practice. This update is effective for the University beginning July 1, 2018 with early adoption permitted. The University has not yet evaluated the impact this guidance may have on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-02, *“Not-for-Profit Entities—Consolidation; Clarifying When a Not-for-Profit Entity That Is a General Partner or a Limited Partner Should Consolidate a For-Profit Limited Partnership or Similar Entity.”* This update amends the consolidation guidance in Subtopic 958-810, Not-for-Profit Entities—Consolidation, to clarify when a NFP that is a general partner or a limited partner should consolidate a for-profit limited partnership or similar legal entity once the amendments in ASU 2015-02 become effective. This update was effective for the University beginning July 1, 2017. The adoption of this guidance did not have a material impact on the consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, *“Compensation – Retirement Benefits; Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.”* This update requires that an employer report the service cost component in the same line items as other compensation costs arising from services rendered by the pertinent employees during the period. In addition, the other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. This update is effective for the University beginning July 1, 2018 with early adoption permitted. The University has not yet evaluated the impact this guidance may have on its consolidated financial statements.

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

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

3. INVESTMENTS

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

<i>(in thousands of dollars)</i>	<u>2018</u>	<u>2017</u>
Money markets	\$ 183,623	\$ 144,065
Fixed income:		
U.S. government/agency	874,684	1,030,281
U.S. corporate	791,604	972,121
Foreign	202,459	183,270
Other	441,925	228,070
Equities	2,135,407	1,911,096
Private capital	<u>1,767,259</u>	<u>1,573,841</u>
Total	<u>\$ 6,396,961</u>	<u>\$ 6,042,744</u>

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

Futures contracts comprise the University's beneficially held derivative instruments at June 30, 2018 and 2017, and are included in the fair value of the University's investments. These contracts are fully cash collateralized and marked to market daily. The fair value of derivative instruments is included in the fair value of the University's investments within the money market category. Futures contracts have minimal credit risk because the counterparties are the exchanges themselves. Fully cash collateralized derivative securities comprised \$4.0 million, 0.06% of total investments, and \$5.2 million, 0.09% of total investments at June 30, 2018 and 2017, respectively. The University's derivatives consist of S&P 500 futures at June 30, 2018 and 2017 and are employed as a low cost, passive investment vehicle with daily liquidity which allows the University to maintain desired market exposure in light of irregular cash flows.

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

<i>(in thousands of dollars)</i>				
<u>2018</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Investment income	\$ 185,372	\$ 1,598	\$ 13,543	\$ 200,513
Net realized gains	73,428	34,663	-	108,091
Net unrealized gains	<u>21,067</u>	<u>34,543</u>	-	<u>55,610</u>
Total returns	<u>\$ 279,867</u>	<u>\$ 70,804</u>	<u>\$ 13,543</u>	<u>\$ 364,214</u>

<i>(in thousands of dollars)</i>				
<u>2017</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Investment income	\$ 162,885	\$ 1,046	\$ 9,056	\$ 172,987
Net realized gains	82,810	43,339	-	126,149
Net unrealized gains	<u>78,072</u>	<u>93,222</u>	-	<u>171,294</u>
Total returns	<u>\$ 323,767</u>	<u>\$ 137,607</u>	<u>\$ 9,056</u>	<u>\$ 470,430</u>

4. ENDOWMENT NET ASSETS

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

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

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

From time to time, due to unfavorable market fluctuations, the fair value of some assets associated with individual donor-restricted endowment funds may fall below the level that donors require to be retained as a perpetual fund, while other assets are unaffected to the same extent and maintain or exceed the level required. The aggregate amount of deficiencies at June 30, 2018 and 2017 was \$1.4 million and \$1.3 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:

<i>(in thousands of dollars)</i>		Temporarily	Permanently	
<u>2018</u>	<u>Unrestricted</u>	<u>Restricted</u>	<u>Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (1,424)	\$ 589,395	\$ 1,511,704	\$ 2,099,675
Funds functioning as endowments	<u>762,836</u>	<u>-</u>	<u>-</u>	<u>762,836</u>
Total net assets	<u>\$ 761,412</u>	<u>\$ 589,395</u>	<u>\$ 1,511,704</u>	<u>\$ 2,862,511</u>
<i>(in thousands of dollars)</i>		Temporarily	Permanently	
<u>2017</u>	<u>Unrestricted</u>	<u>Restricted</u>	<u>Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (1,299)	\$ 521,602	\$ 1,424,224	\$ 1,944,527
Funds functioning as endowments	<u>651,647</u>	<u>-</u>	<u>-</u>	<u>651,647</u>
Total net assets	<u>\$ 650,348</u>	<u>\$ 521,602</u>	<u>\$ 1,424,224</u>	<u>\$ 2,596,174</u>

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

<i>(in thousands of dollars)</i>		<u>Temporarily</u>	<u>Permanently</u>	
<u>2018</u>	<u>Unrestricted</u>	<u>Restricted</u>	<u>Restricted</u>	<u>Total</u>
Endowment net assets, beginning of the year	\$ 650,348	\$ 521,602	\$ 1,424,224	\$ 2,596,174
Endowment return:				
Endowment earnings	31,280	17	3,805	35,102
Net realized gains	86,307	33,681	-	119,988
Net unrealized gains	11,891	33,442	-	45,333
Reclassification of funds with deficiencies	<u>(125)</u>	<u>125</u>	<u>-</u>	<u>-</u>
Total endowment return	<u>129,353</u>	<u>67,265</u>	<u>3,805</u>	<u>200,423</u>
Contributions	-	528	83,675	84,203
Endowment spending	(105,183)	-	-	(105,183)
Transfers to create funds functioning as endowments	<u>86,894</u>	<u>-</u>	<u>-</u>	<u>86,894</u>
Endowment net assets, end of the year	<u>\$ 761,412</u>	<u>\$ 589,395</u>	<u>\$ 1,511,704</u>	<u>\$ 2,862,511</u>
 <i>(in thousands of dollars)</i>				
<u>2017</u>	<u>Unrestricted</u>	<u>Temporarily</u>	<u>Permanently</u>	<u>Total</u>
Endowment net assets, beginning of the year	\$ 587,234	\$ 398,384	\$ 1,330,966	\$ 2,316,584
Endowment return:				
Endowment earnings	22,650	20	3,398	26,068
Net realized gains	89,401	41,482	-	130,883
Net unrealized gains	27,652	87,277	-	114,929
Reclassification of funds with deficiencies	<u>6,054</u>	<u>(6,054)</u>	<u>-</u>	<u>-</u>
Total endowment return	<u>145,757</u>	<u>122,725</u>	<u>3,398</u>	<u>271,880</u>
Contributions	-	493	89,860	90,353
Endowment spending	(98,521)	-	-	(98,521)
Transfers to create funds functioning as endowments	<u>15,878</u>	<u>-</u>	<u>-</u>	<u>15,878</u>
Endowment net assets, end of the year	<u>\$ 650,348</u>	<u>\$ 521,602</u>	<u>\$ 1,424,224</u>	<u>\$ 2,596,174</u>

Not included above are the endowment net assets of subsidiaries of \$20.2 million and \$18.1 million as of June 30, 2018 and 2017, 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 2018 and 2017) 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 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, 2018 about the University's financial assets and liabilities that are measured at fair value on a recurring basis:

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

The following table presents information as of June 30, 2017 about the University's financial assets and liabilities that are measured at fair value on a recurring basis:

<i>(in thousands of dollars)</i>	Quoted Prices in Active Markets For Identical Assets <u>Level 1</u>	Significant Other Observable Inputs <u>Level 2</u>	Significant Unobservable Inputs <u>Level 3</u>	Total <u>Fair Value</u>
Assets:				
Long-term Investment Pool:				
Money markets	\$ 128,632	\$ -	\$ -	\$ 128,632
Fixed income				
U.S. government/agency	85,021	80,107	-	165,128
U.S. corporate	-	243,578	-	243,578
Foreign	-	86,431	-	86,431
Other	-	32,905	-	32,905
Equities	<u>1,102,498</u>	-	-	<u>1,102,498</u>
Total	<u>\$ 1,316,151</u>	<u>\$ 443,021</u>	<u>\$ -</u>	<u>\$ 1,759,172</u>
Operating investments:				
Money markets	\$ 15,424	\$ 9	\$ -	\$ 15,433
Fixed income				
U.S. government/agency	633,619	231,535	-	865,154
U.S. corporate	82,513	646,029	-	728,542
Foreign	11,948	84,892	-	96,840
Other	20,031	175,134	-	195,165
Equities	<u>146,726</u>	<u>16</u>	<u>4,688</u>	<u>151,430</u>
Total	<u>\$ 910,261</u>	<u>\$ 1,137,615</u>	<u>\$ 4,688</u>	<u>\$ 2,052,564</u>
Deposits held by bond trustees:				
Money markets	\$ 178,954	\$ -	\$ -	\$ 178,954
Beneficial interest in perpetual trusts				
	\$ -	\$ -	\$ 19,854	\$ 19,854
Liabilities:				
Present value of annuities payable	\$ -	\$ -	\$ 58,070	\$ 58,070

The fair value tables above exclude investments of \$2,824.1 million and \$2,231.0 million as of June 30, 2018 and 2017, 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, 2018 and 2017, fair value of endowment funds and funds functioning as endowments within the LTIP totaled \$2,891.7 million and \$2,615.6 million, respectively. At June 30, 2018 and 2017, fair value of operating funds included in the LTIP totaled \$1,398.3 million and \$1,370.9 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, 2018:

<i>(in thousands of dollars)</i>	<u>Operating Investments</u>	<u>Beneficial Interest in Perpetual Trusts</u>
<u>Assets:</u>		
Beginning balance	\$ 4,688	\$ 19,854
Total realized and unrealized gains	602	3,651
Gifts	-	82
Purchases	7	-
Ending balance	<u>\$ 5,297</u>	<u>\$ 23,587</u>
	<u>Present Value of Annuities Payable</u>	
<u>Liabilities:</u>		
Beginning balance	\$ 58,070	
Actuarial adjustment of liability	2,255	
Gifts	986	
Sales	(2,075)	
Ending balance	<u>\$ 59,236</u>	

The following tables present information related to changes in Level 3 for each category of financial assets and liabilities for year ended June 30, 2017:

<i>(in thousands of dollars)</i>	<u>Operating Investments</u>	<u>Beneficial Interest in Perpetual Trusts</u>
<u>Assets:</u>		
Beginning balance	\$ 4,214	\$ 14,558
Total realized and unrealized gains	540	5,296
Sales	(66)	-
Ending balance	<u>\$ 4,688</u>	<u>\$ 19,854</u>
	<u>Present Value of Annuities Payable</u>	
<u>Liabilities:</u>		
Beginning balance	\$ 53,859	
Actuarial adjustment of liability	3,460	
Gifts	3,144	
Sales	(2,393)	
Ending balance	<u>\$ 58,070</u>	

There were no transfers of assets between Level 3 and Level 2 and between Level 1 and Level 2 in 2018 and 2017.

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, 2018 and 2017:

<i>(in thousands of dollars)</i>	Fair Value		Unfunded	Redemption	Redemption
	2018	2017	Commitments		
			At	Frequency	Notice Period
			June 30, 2018		
Commingled Funds:				Quarterly/	
Non-U.S. Equity	\$ 927,415	\$ 627,998		Daily/Monthly	5-90 days
Subtotal	<u>\$ 927,415</u>	<u>\$ 627,998</u>			
Marketable Investment Partnerships:					
Absolute Return	\$ 59,528	\$ 56,471		Quarterly	60 days
Distressed Debt	54,317	60,406		Quarterly/	60-90 days
Commodities	82,833	126,846		Semi Annual	30-60 days
				Monthly	
Opportunistic	268,806	123,387		Monthly/	
Directional Long/Short	303,068	289,472		Quarterly/	30-90 days
Subtotal	<u>\$ 768,552</u>	<u>\$ 656,582</u>		Annually	30 days
				Monthly	
Non-Marketable Investment Partnerships:					
Private Real Estate	\$ 66,430	\$ 83,925	\$ 55,910		
Venture Capital	383,882	323,408	188,914		
Private Equity	390,952	297,386	311,824		
Natural Resources	142,396	130,146	55,451		
Private Debt	144,497	111,563	205,236		
Subtotal	<u>\$ 1,128,157</u>	<u>\$ 946,428</u>	<u>\$ 817,335</u>		
Total	<u>\$ 2,824,124</u>	<u>\$ 2,231,008</u>	<u>\$ 817,335</u>		

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

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

Nonmarketable Investment Partnerships include limited partnership interests in a variety of illiquid investments. The fair values of the investments for each fund in this category have been estimated using the net asset value of the LTIP's ownership interest in partner's capital and cannot be redeemed. Realizations from each fund are received as the underlying investments are liquidated or distributed, typically within 10 years after initial commitment. Unfunded commitments represent remaining commitments of the LTIP's drawdown funds as of June 30, 2018. Five major investment strategies are included within this category. Private Real Estate includes properties primarily located in the U.S. Venture Capital includes non-public startups and enterprises in early stages of growth located globally. Private Equity includes buyouts of previously public companies as well as enterprises that are planning to go public in the near future, including

funds focusing on opportunities outside the U.S. Natural Resources largely include companies primarily involved in oil and natural gas in addition to a variety of other natural resources. Private Debt includes global private credit securities rated below investment grade as well as non-rated debt.

6. CONTRIBUTIONS RECEIVABLE

Contributions receivable are summarized as follows as of June 30:

<i>(in thousands of dollars)</i>	<u>2018</u>	<u>2017</u>
In one year or less	\$ 69,963	\$ 66,076
Between one year and five years	70,295	78,025
More than five years	<u>114,750</u>	<u>112,650</u>
Contributions receivable, gross	255,008	256,751
Less allowance	(6,427)	(4,299)
Less discount	<u>(52,096)</u>	<u>(51,394)</u>
Contributions receivable, net	<u>\$ 196,485</u>	<u>\$ 201,058</u>

Contributions received during the years ended June 30, 2018 and 2017 are discounted at rates ranging from 2.33% to 2.90% and 1.24% to 2.46%, respectively. The discount rates for prior periods ranged from 0.11% to 6.28%.

At June 30, 2018 and 2017, the University has received bequest intentions and certain other conditional promises to give of \$104.6 million and \$103.3 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, 2018:

	<i>(in thousands of dollars)</i>
Balance at the beginning of year	\$ 201,058
New pledges	100,794
Collections on pledges	(102,537)
Increase in allowance	(2,128)
Increase in unamortized discounts	<u>(702)</u>
Balance at the end of year	<u>\$ 196,485</u>

7. 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:

<i>(in thousands of dollars)</i>	<u>2018</u>	<u>2017</u>
<u>The Pennsylvania State University Bonds</u>		
Series 2018	\$ 64,210	\$ -
Series 2017A	157,080	157,080
Series 2017B	125,000	125,000
Series 2016A	119,580	122,165
Series 2016B	221,480	229,775
Series 2015A	62,320	63,780
Series 2015B	104,335	108,000
Series 2010	127,580	131,380
Series 2009B	74,235	74,235
Series 2007B	47,545	51,065
 <u>Pennsylvania Higher Educational Facilities Authority University Revenue Bonds (issued for The Pennsylvania State University)</u>		
Series 2006	2,410	2,655
Series 2004	2,540	2,840
Series 2002	1,995	2,435
 <u>Lycoming County Authority College Revenue Bonds (issued for Penn College)</u>		
Series 2016	52,465	54,190
Series 2015	5,030	6,390
Series 2012	23,255	24,275
Series 2011	<u>37,735</u>	<u>37,810</u>
Total bonds payable	1,228,795	1,193,075
Unamortized bond premiums	146,254	142,442
Unamortized deferred bond costs	(5,981)	(5,952)
 <u>Notes payable and capital leases</u>		
Notes payable	24,632	26,983
Capital lease obligations	<u>56,477</u>	<u>112,845</u>
Total notes payable and capital leases	<u>81,109</u>	<u>139,828</u>
Total long-term debt	<u>\$ 1,450,177</u>	<u>\$ 1,469,393</u>

<u>Debt issuance</u>	<u>Interest rate mode</u>	<u>Interest rates</u>	<u>Payment ranges and maturity</u> <i>(in thousands of dollars)</i>
The Pennsylvania State University Bonds			
Series 2018	Fixed	2.00% - 5.00%	\$975 to \$2,320 through September 2037 with \$16,650 and \$18,255 due September 2043 and September 2048, respectively
Series 2017A	Fixed	2.00% - 5.00%	\$2,400 to \$5,965 through September 2037 with \$34,750 and \$44,620 due September 2042 and September 2047, respectively
Series 2017B	Fixed	1.275% - 3.793%	\$2,660 to \$3,830 through September 2032 with \$21,305 and \$56,595 due September 2037 and September 2047, respectively
Series 2016A	Fixed	5.00%	\$2,690 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	4.00% - 5.00%	\$1,520 to \$3,445 through September 2035 with \$20,000 due September 2040
Series 2015B	Fixed	4.00% - 5.00%	\$3,820 to \$8,435 through September 2035
Series 2010	Fixed	3.375% - 5.00%	\$3,955 to \$6,595 through March 2030 with \$21,805 and \$44,245 due March 2035 and March 2040, respectively
Series 2009B	Variable	1.73%	June 2031
Series 2007B	Fixed	5.25%	\$3,710 to \$5,955 through August 2027

Pennsylvania Higher Educational Facilities Authority ("PHEFA") University Revenue Bonds

Series 2006	Fixed	4.35% - 5.125%*	\$255 to \$280 through September 2020 with \$1,610 due September 2025
Series 2004	Fixed	4.70% - 5.00%*	\$310 to \$325 through September 2019 with \$1,905 due September 2024
Series 2002	Fixed	5.00%*	\$2,435 due March 2022

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

Lycoming County Authority College Revenue Bonds

Series 2016	Fixed	2.125% - 5.00%	\$1,545 to \$3,615 through October 2032 with \$19,345 due October 2037
Series 2015	Fixed	2.50% - 4.00%	\$465 to \$1,590 through January 2025
Series 2012	Fixed	2.50% - 5.00%	\$1,080 to \$1,170 through May 2020 with \$2,565, \$6,395 and \$12,045 due May 2022, May 2026 and May 2032, respectively
Series 2011	Fixed	4.00% - 5.24%	\$1,565 to \$1,850 through July 2021 with \$14,170 and \$18,705 due July 2026 and July 2030, respectively

The Series 2018 Bonds are general obligation bonds issued in May 2018 for the purpose of financing various construction and renovation projects. The Series 2018 Bonds are subject to early redemption provisions, at the option of the University, beginning September 2028. The bonds maturing in September 2043 and September 2048 are subject to mandatory sinking fund redemption.

The Series 2009B Bonds are currently paying interest on a variable rate basis at a long term rate for the period June 1, 2018 through May 31, 2019. The University has the option to convert to another variable rate (daily, weekly, monthly or flexible) or to a fixed rate basis (such rates are generally determined on a market basis) at respective conversion dates. The bonds currently pay interest at 1.73% with adjustment on the respective date to the rate the remarketing agent believes will cause the bonds to have a market value equal to the principal. The 2009B bondholders have the right to tender bonds on the purchase dates while such bonds bear interest at the daily, weekly or monthly rate. The 2009B Bonds were issued subject to the self-liquidity program established

by the University on the date of issuance pursuant to which the University will provide liquidity for the 2009B Bonds from its general funds in the event of insufficient remarketing proceeds.

The University has complied with all financial debt covenants for the years ended June 30, 2018 and 2017.

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

<u>Year</u>	<u>Annual Installments</u> <i>(in thousands of dollars)</i>
2019	\$ 35,825
2020	38,760
2021	40,475
2022	42,390
2023	44,380
Thereafter	<u>1,026,965</u>
	<u>\$ 1,228,795</u>

The fair value of the University's bonds payable is estimated based on current rates offered for similar issues with similar security, terms and maturities using available market information as supplied by the various financial institutions who act as trustees or custodians for the University. At June 30, 2018, the carrying value and estimated fair value of the University's bonds payable, including issuance premiums and deferred bond costs, are \$1,369.1 million and \$1,347.6 million, respectively. At June 30, 2017, the carrying value and estimated fair value of the University's bonds payable, including issuance premiums and deferred bond costs, were \$1,329.6 million and \$1,337.5 million, respectively. Certain bond issues have associated issuance premiums; these issuance premiums total \$146.3 million and \$142.4 million at June 30, 2018 and 2017, respectively and are presented within the statement of financial position as long-term debt. These issuance premiums will be amortized over the term of the respective outstanding bonds. Certain bond issues have associated deferred bond costs; these deferred bond costs total \$6.0 million at June 30, 2018 and 2017 and are presented within the statement of financial position as a reduction in long-term debt. These deferred bond costs will be amortized over the term of the respective outstanding bonds.

Notes payable and capital leases

The University has three notes payable included within the consolidated statements of financial position at June 30, 2018 with balances of \$6.9 million, \$8.0 million, and \$9.7 million. These notes have payments due annually through June 2024, June 2025, and March 2026 and bear interest at 2.60%, 2.85%, and 2.80%, respectively. The current portion of payments due under these notes totals \$3.3 million at June 30, 2018.

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, 2018 are as follows:

<u>Year</u>	<i>(in thousands of dollars)</i>
2019	\$ 13,767
2020	10,901
2021	8,444
2022	5,308
2023	4,202
Thereafter	<u>33,833</u>
Total minimum lease payments	76,455
Less imputed interest	<u>(19,978)</u>
Capital lease obligation	56,477
Current portion	<u>11,469</u>
Long-term portion	<u>\$ 45,008</u>

8. OPERATING LEASES

The University has certain lease agreements in effect which are considered operating leases. During the year ended June 30, 2018, the University recorded expenses of \$22.1 million for leased equipment and \$31.1 million for leased building space. During the year ended June 30, 2017, the University recorded expenses of \$23.6 million for leased equipment and \$30.5 million for leased building space.

Future minimum lease payments under operating leases as of June 30, 2018 are as follows:

<u>Year</u>	<i>(in thousands of dollars)</i>
2019	\$ 30,152
2020	20,656
2021	14,497
2022	10,919
2023	8,574
Thereafter	<u>29,345</u>
Total minimum lease payments	<u>\$ 114,143</u>

9. RETIREMENT BENEFITS

The University provides retirement benefits for substantially all regular employees, primarily through either contributory defined benefit plans administered by the Commonwealth of Pennsylvania State Employees' Retirement System ("SERS") 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 (\$121.0 million and \$104.9 million for the years ended June 30, 2018 and 2017, respectively). The University's total cost for retirement benefits, included in expenses, is \$269.7 million and \$246.3 million for the years ended June 30, 2018 and 2017, 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, 2018 and 2017 were \$118.2 million and \$102.6 million, respectively, and represent approximately 6.0% of total contributions to the plan based on projections for fiscal year 2018. The plan is funded at less than 65% with the funded ratio of the plan at 59.4% as of December 31, 2017.

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 (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, death benefits and other expenses are paid from the unrestricted net assets 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 unrestricted net assets at June 30, 2018 and 2017 are the following amounts that have not yet been recognized in net periodic postretirement cost: unrecognized prior service cost (benefit) of (\$4.1) million and (\$8.5) million and unrecognized actuarial loss of \$459.7 million and \$707.6 million, respectively.

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

Change in benefit obligation:

(in thousands of dollars)

	<u>2018</u>	<u>2017</u>
Benefit obligation at beginning of year	\$ 2,318,462	\$ 2,148,522
Service cost	47,477	50,368
Interest cost	92,448	90,719
Actuarial loss (gain)	(95,091)	33,287
Benefits paid	(58,199)	(51,860)
Plan amendment	1,312	(6,845)
Plan assumptions	<u>(112,854)</u>	<u>54,271</u>
Benefit obligation at end of year	<u>\$ 2,193,555</u>	<u>\$ 2,318,462</u>

Change in plan assets:

(in thousands of dollars)

	<u>2018</u>	<u>2017</u>
Fair value of plan assets at beginning of year	\$ -	\$ -
Employer contributions	58,199	51,860
Benefits paid	<u>(58,199)</u>	<u>(51,860)</u>
Fair value of plan assets at end of year	<u>\$ -</u>	<u>\$ -</u>
Funded status	\$ (2,193,555)	\$ (2,318,462)
Unrecognized prior service cost (benefit)	-	-
Unrecognized net actuarial loss	-	-
Accrued postretirement benefit expense	<u>\$ (2,193,555)</u>	<u>\$ (2,318,462)</u>

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

	<u>2018</u>	<u>2017</u>
Service cost	\$ 47,477	\$ 50,368
Interest cost	92,448	90,719
Amortization of prior service cost	(3,131)	(19,392)
Amortization of unrecognized net loss	<u>40,003</u>	<u>48,990</u>
Net periodic postretirement cost	<u>\$ 176,797</u>	<u>\$ 170,685</u>

The assumed healthcare cost trend rate used in measuring the accumulated postretirement benefit obligation was 7.20% and 7.50% for the years ended June 30, 2018 and 2017, respectively, reduced each year to an ultimate level of 5.00%. The postretirement benefit obligation discount rate was 4.46% and 4.21% for the years ended June 30, 2018 and 2017, respectively. During 2018, the plan had favorable demographic experience compared to assumptions. In addition, the plan had positive per capita medical claims experience over the past 3 years contributing to favorable results during 2018.

If the healthcare cost trend rate assumptions were increased by 1% in each year, the accumulated postretirement benefit obligation would be increased by \$452.6 million and \$498.4 million as of June 30, 2018 and 2017, 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 \$34.2 million and \$35.5 million as of June 30, 2018 and 2017, respectively. If the healthcare cost trend rate assumptions were decreased by 1% in each year, the accumulated postretirement benefit obligation would be decreased by \$348.3 million and \$384.9 million as of June 30, 2018 and 2017, 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 \$25.7 million and \$26.6 million as of June 30, 2018 and 2017, 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:

	<i>(in thousands of dollars)</i>
2019	\$ 61,286
2020	65,658
2021	70,434
2022	75,589
2023	80,977
2024-28	486,823

11. PENN STATE HEALTH

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

The wholly owned subsidiaries of the Health System include the Milton S. Hershey Medical Center ("MSHMC"), Saint Joseph's Regional Health Network and Medical Group ("SJRHN/SJMG"), Penn State Community Medical Group ("PSCMG"), Nittany Health, Inc. ("Nittany"), Central PA Health Network ("CIN") and 4814 Development Assoc., Inc. ("4814 DA, Inc.").

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 unrestricted net assets within the consolidated statements of financial position with a value at June 30, 2018 and 2017 of \$1.9 million and \$4.6 million, respectively.

In May 2016, the ownership of MSHMC transferred from the University to the Health System. At June 30, 2018, 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 16 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 4814 DA, Inc. The purpose of 4814 DA, Inc. 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 January 2018, Highmark Health purchased a 20% minority interest in the Health System. The Health System received cash contributions of \$200.0 million in exchange for three board seats and certain reserve powers. The contributions are recorded as capital contributions within non-controlling interest on the statement of activities. Additionally, the Health System recorded non-controlling interest, excess of revenues over expenses of \$21.7 million related to this minority interest. The total non-controlling interest related to Highmark Health is recorded in unrestricted net assets within the consolidated statements of financial position with a value at June 30, 2018 of \$221.7 million.

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

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 \$1,239.8 million of which \$1,019.8 million has been paid or accrued as of June 30, 2018. 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 \$31.8 million and \$25.7 million as of June 30, 2018 and 2017, respectively. These letters of credit are used primarily to comply with minimum state and federal regulatory laws that govern various University activities. The fair value of these letters of credit approximates contract values based on the nature of the fee arrangements with the issuing banks.

Guarantees

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

Self-Insurance

The University has a coordinated program of commercial and self-insurance for medical malpractice claims at MSHMC through the use of a qualified trust and a domestic captive insurance company in combination with a self-insured retention layer and is supplementing this program through participation in the Pennsylvania Medical Care Availability and Reduction of Error Fund ("MCARE Fund"), in accordance with Pennsylvania law. An estimate of the present value, discounted at 2% for the years ended June 30, 2018 and 2017, of the medical malpractice claims liability in the amount of \$131.1 million and \$120.4 million is recorded as of June 30, 2018 and 2017, respectively.

The subsidiaries of the Health System are self-insured for all medical malpractice claims asserted on or after July 1, 2003, for all amounts that are below the coverage of excess insurance policies and not included in the insurance coverage of the MCARE Fund. Under the self-insurance program, the Health System is required to maintain a malpractice trust fund in an amount at least equal to the expected loss of known claims. The balance of this trust fund was \$31.5 million and \$27.4 million at June 30, 2018 and 2017, respectively. The Health System intends to fund any claims due during the next year from cash flows from operations.

With approval from the Pennsylvania Department of Labor and Industry ("PA-DLI"), the University elected to self-insure potential obligations applicable to Pennsylvania workers' compensation. Certain claims under the program are contractually administered by a private agency. The University purchased insurance coverage for excess obligations over \$600,000 per incident. An estimate of the self-insured workers' compensation claims liability in the amount of \$6.8 million and \$7.0 million, discounted at 2.73% and 1.89%, respectively, is recorded as of June 30, 2018 and 2017, respectively. The University has established a trust fund, in the amount of \$13.2 million at June 30, 2018 and 2017 as required by PA-DLI, to provide for the payment of claims under this self-insurance program. The Health System is self-insured for workers' compensation claims and has purchased excess policies through commercial insurers which cover individual claims in excess of \$750,000 per incident for workers' compensation claims.

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

Litigation and Contingencies

In November 2011, the University was made aware of certain allegations in a Commonwealth of Pennsylvania Grand Jury presentment. Various legal proceedings and investigations have arisen as a result of such allegations, including criminal proceedings against former officers and employees of the University. Certain claims and civil litigation have been filed against the University with anticipation that other complaints could be filed. The University has recognized an expense of \$4.0 million and \$16.0 million for the years ended June 30, 2018 and 2017, respectively, with such amounts included in institutional support within the consolidated statement of activities. Additional claims could be paid in the future but without having knowledge of the number and nature of such claims the University is unable to predict the outcome of these matters or the ultimate legal and financial liability and at this time cannot reasonably estimate the possible loss or range of loss. Accordingly, no amounts have been accrued in the financial statements for these claims.

In addition to the settlement costs, the University has incurred costs for the fiscal years ended June 30, 2018 and 2017 totaling \$3.5 million and \$4.9 million, respectively, for internal investigation, legal, communications and other related costs. These costs are included in institutional support within the consolidated statement of activities.

By jury verdict and court orders in October and November 2016 and March 2017, the University was found liable for compensatory and punitive damages of \$12.3 million and was ordered to pay attorney's fees and costs of \$1.7 million in a lawsuit brought by a former employee alleging whistleblower liability, defamation and misrepresentation. In October 2017, the University agreed to settle with the plaintiff for a lesser amount pursuant to a confidential settlement agreement. The amount per the settlement agreement is accrued as of June 30, 2017 and included in institutional support within the consolidated statement of activities.

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

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

On July 12, 2013, the University received a preliminary report from the U.S. Department of Education based on the program review of the University's compliance with the Clery Act, a federal law related to campus safety. A final program review determination was made in November 2016, which assessed a fine in the amount of \$2.4 million. The fine has been paid and the Department of Education's program review is now closed.

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

13. SUBSEQUENT EVENTS

The University has evaluated subsequent events through October 23, 2018, 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.



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as of June 30, 2018

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