PENNSTATE

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Audited Financial Statements

The Pennsylvania State University
Fiscal Year Ended June 30, 2009

THE PENNSYLVANIA STATE UNIVERSITY

UNIVERSITY OFFICERS
as of October 16, 2009

GRAHAM B. SPANIER
President

RODNEY A. ERICKSON
Executive Vice President and
Provost

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

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

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

EVA J. PELL
Senior Vice President for Research and
Dean, Graduate School

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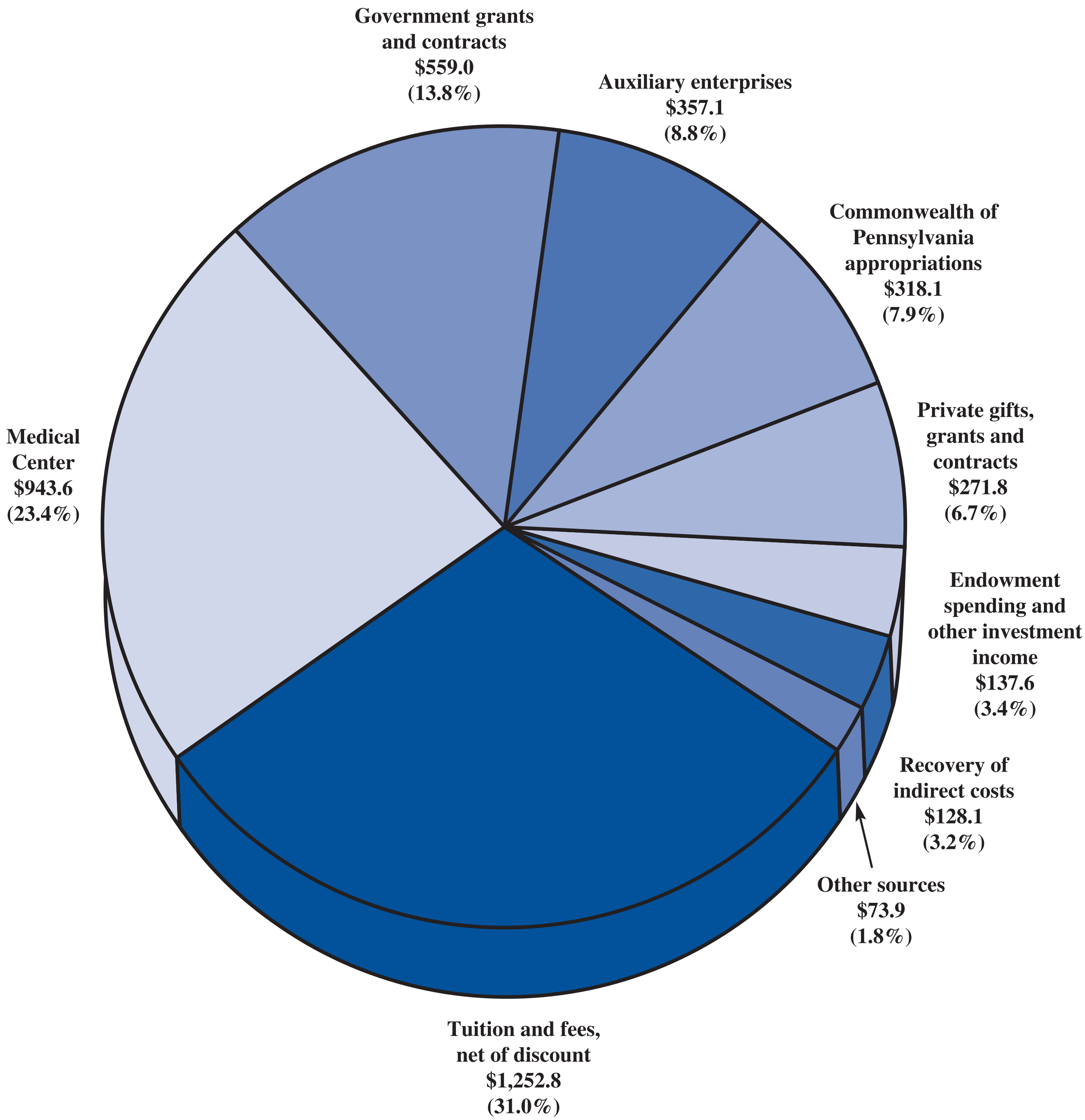
OPERATING REVENUES BY SOURCE ($4.0 billion)

For the Year Ended June 30, 2009

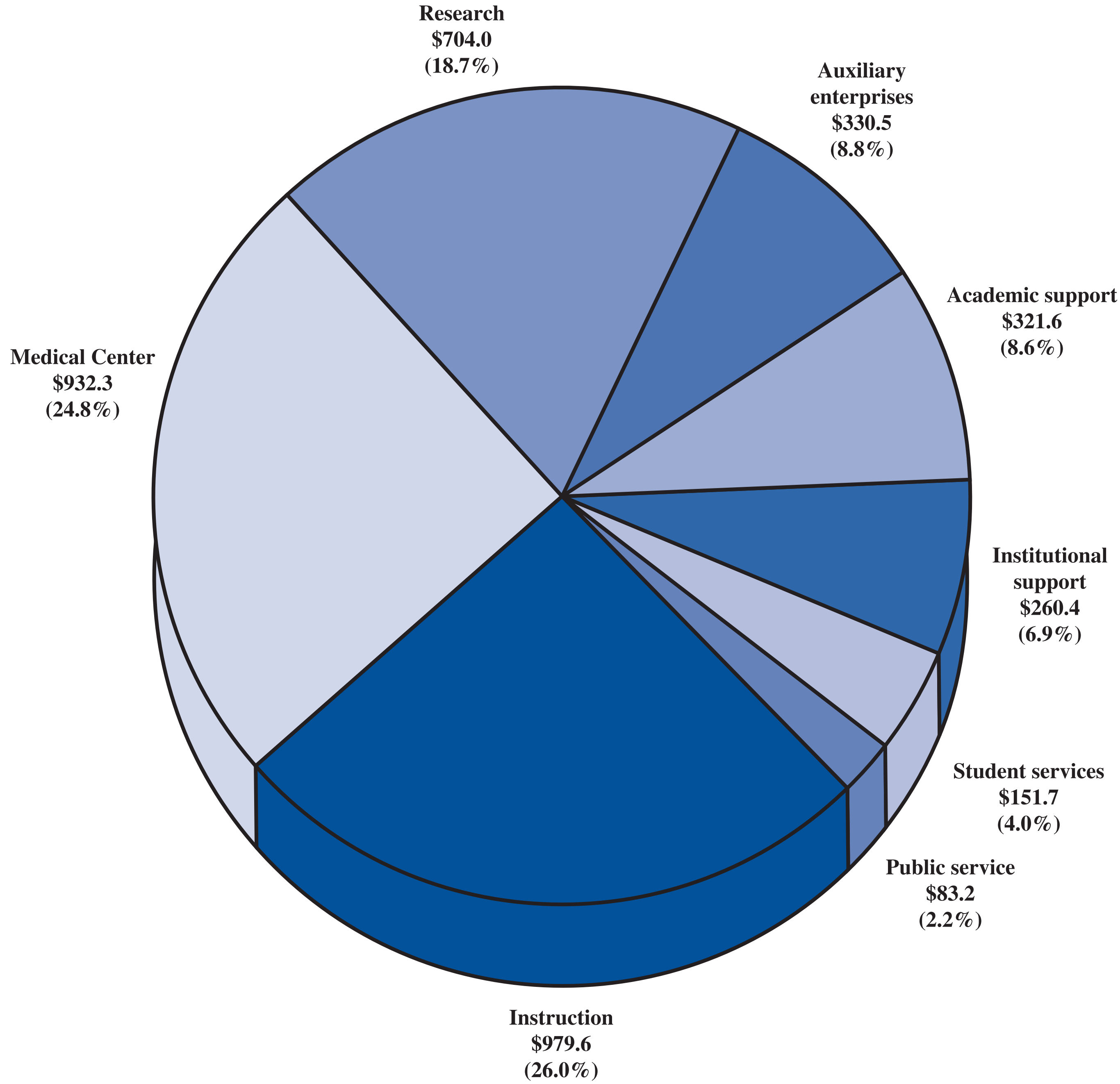
($ in Millions)



OPERATING EXPENSES BY FUNCTION ($3.8 billion)

For the Year Ended June 30, 2009

($ in Millions)



PENNSTATE

Joseph J. Doncsecz
Corporate Controller

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

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

October 16, 2009

Dr. Graham Spanier, President
The Pennsylvania State University

Dear Dr. Spanier:

The audited consolidated financial statements of The Pennsylvania State University and subsidiaries (the "University") for the fiscal year ended June 30, 2009 are presented on the accompanying pages. These financial statements represent a complete and permanent record of the finances of the University for the year.

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

Respectfully submitted,

Joseph J. Doncsecz
Corporate Controller

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

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

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated statements of financial position of The Pennsylvania State University and subsidiaries (the "University") as of June 30, 2009 and 2008, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the University as of June 30, 2009 and 2008, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

October 16, 2009

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
ASSETS
JUNE 30, 2009 AND 2008
(in thousands)

	June 30, 2009	June 30, 2008
Current assets:		
Cash and cash equivalents	$ 1,094,807	$ 596,456
Short-term investments	132,106	298,037
Deposits held by bond trustees	125,864	-
Deposits held for others	25,272	24,837
Accounts receivable, net of allowances of $25,320 and $22,226	407,625	373,950
Contributions receivable, net	54,101	39,269
Loans to students, net of allowances of $504 and $4,601	8,444	10,422
Inventories	31,572	29,916
Prepaid expenses and other assets	59,436	53,096
Investments held under securities lending program	253,696	265,725
Total current assets	2,192,923	1,691,708
Noncurrent assets:		
Deposits held by bond trustees	6,676	6,770
Contributions receivable, net	122,958	106,430
Loans to students, net of allowances of $2,855 and $14,570	48,075	33,192
Deferred bond costs, net	6,813	6,268
Total investment in plant, net	2,970,322	2,732,744
Beneficial interest in perpetual trusts	11,025	13,673
Investments	2,358,585	3,066,609
Total noncurrent assets	5,524,454	5,965,686
Total assets	$ 7,717,377	$ 7,657,394

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
LIABILITIES AND NET ASSETS
JUNE 30, 2009 AND 2008
(in thousands)

	June 30, 2009	June 30, 2008
Current liabilities:		
Accounts payable and other accrued expenses	$ 390,675	$ 383,612
Deferred revenue	217,243	206,519
Long-term debt	51,884	53,098
Present value of annuities payable	5,038	5,520
Accrued postretirement benefits	31,752	29,139
Liability under securities lending program	253,696	265,725
Total current liabilities	950,288	943,613
Noncurrent liabilities:		
Deposits held in custody for others	46,018	37,750
Deferred revenue	17,039	19,556
Long-term debt	1,080,555	969,764
Present value of annuities payable	31,928	36,018
Accrued postretirement benefits	1,012,433	895,198
Refundable United States Government student loans	44,169	35,442
Other liabilities	131,376	130,599
Total noncurrent liabilities	2,363,518	2,124,327
Total liabilities	3,313,806	3,067,940
Net assets:		
Unrestricted -		
Undesignated	1,386	987
Designated for specific purposes	1,424,815	1,576,579
Net investment in plant	1,759,274	1,602,885
Total unrestricted	3,185,475	3,180,451
Temporarily restricted	244,116	514,094
Permanently restricted	973,980	894,909
Total net assets	4,403,571	4,589,454
Total liabilities and net assets	$ 7,717,377	$ 7,657,394

See notes to consolidated financial statements.

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

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

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2008
(in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating revenues and other support:				
Tuition and fees, net of discounts of $99,518	$ 1,143,041	$ -	$ -	$ 1,143,041
Commonwealth of Pennsylvania -				
Appropriations	334,230	-	-	334,230
Special contracts	104,967	-	-	104,967
Department of General Services projects	53,499	-	-	53,499
United States Government grants and contracts	394,986	-	-	394,986
Private grants and contracts	149,374	-	-	149,374
Gifts and pledges	56,084	47,530	-	103,614
Endowment spending	60,390	-	-	60,390
Other investment income	73,990	6,907	-	80,897
Sales and services of educational activities	49,726			49,726
Recovery of indirect costs	118,637	-	-	118,637
Auxiliary enterprises	321,632	-	-	321,632
Medical Center revenue	874,977	-	-	874,977
Other sources	17,954	-	-	17,954
Net assets released from restrictions	27,493	(27,493)	-	-
Total operating revenues and other support	3,780,980	26,944	-	3,807,924
Operating expenses:				
Educational and general -				
Instruction	906,308	-	-	906,308
Research	673,244	-	-	673,244
Public service	91,836	-	-	91,836
Academic support	283,954	-	-	283,954
Student services	134,974	-	-	134,974
Institutional support	264,174	-	-	264,174
Total educational and general	2,354,490	-	-	2,354,490
Auxiliary enterprises	281,817	-	-	281,817
Medical Center expense	863,239	-	-	863,239
Total operating expenses	3,499,546	-	-	3,499,546
Increase in net assets from operating activities	281,434	26,944	-	308,378
Non-operating activities:				
Gifts and pledges	-	-	50,108	50,108
Current year realized and unrealized gains (losses)	(46,889)	(98,384)	9,411	(135,862)
Endowment appreciation utilized	(26,639)	-	-	(26,639)
Changes in funds held by others in perpetuity	-	706	(1,280)	(574)
Write-offs and disposals of assets	(5,505)	-	-	(5,505)
Actuarial adjustment on annuities payable	-	(2,641)	(2,174)	(4,815)
Increase (decrease) in net assets from non-operating activities	(79,033)	(100,319)	56,065	(123,287)
Increase (decrease) in net assets	202,401	(73,375)	56,065	185,091
Net assets at the beginning of the year	2,978,050	587,469	838,844	4,404,363
Net assets at the end of the year	$ 3,180,451	$ 514,094	$ 894,909	$ 4,589,454

See notes to consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2009 AND 2008
(in thousands)

	June 30, 2009	June 30, 2008
Cash flows from operating activities:		
(Decrease) increase in net assets	$ (185,883)	$ 185,091
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Actuarial adjustment on annuities payable	463	4,815
Contributions restricted for long-term investment	(75,722)	(66,835)
Interest and dividends restricted for long-term investment	(13,166)	(24,630)
Net realized and unrealized losses on long-term investments	455,201	126,706
Depreciation and amortization expense	202,216	193,014
Write-offs and disposals of assets	5,653	5,850
Contributions of land, buildings and equipment	(1,023)	(2,789)
Buildings and equipment provided by Pennsylvania Department of General Services	(633)	(26,377)
Contribution to government student loan funds	454	4,054
Provision for bad debts	22,899	22,998
Increase in deposits held for others	(436)	(3,732)
Increase in receivables	(76,426)	(76,697)
Increase in inventories	(1,656)	(2,000)
Increase in prepaid expenses and other assets	(15,359)	(28,118)
Increase in accounts payable and other accrued expenses	30,493	36,119
Increase in deferred revenue	8,207	10,729
Increase in accrued postretirement benefits	119,848	89,774
Net cash provided by operating activities	475,130	447,972
Cash flows from investing activities:		
Purchase of land, buildings and equipment	(415,594)	(325,180)
Increase in deposits held by bond trustees	(125,770)	11,388
Advances on student loans	(8,505)	(13,115)
Collections on student loans	7,175	6,976
Decrease in investments held under securities lending program	12,029	43,956
Decrease in liability under securities lending program	(12,029)	(43,956)
Purchase of investments	(4,642,005)	(5,065,459)
Proceeds from sale of investments	5,026,450	4,917,285
Net cash used in investing activities	(158,249)	(468,105)
Cash flows from financing activities:		
Contributions restricted for long-term investment	75,722	66,835
Interest and dividends restricted for long-term investment	13,166	24,630
Payments of annuity obligations	(5,100)	(5,571)
Proceeds from issuance of bonds	225,003	145,368
Principal payments on notes, bonds and capital leases	(127,826)	(61,714)
Proceeds related to government student loan funds, net of collection costs	505	485
Net cash provided by financing activities	181,470	170,033
Net increase in cash and cash equivalents	498,351	149,900
Cash and cash equivalents at the beginning of the year	596,456	446,556
Cash and cash equivalents at the end of the year	$ 1,094,807	$ 596,456

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, 2009 AND 2008

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.

<u>Basis of Presentation</u>

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

<u>Basis of Accounting</u>

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

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

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

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

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

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

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts on the financial statements and the disclosure of contingencies and commitments. Actual results could differ from those estimates.

In 2009, the University evaluated the allowance for loans to students and changed to a methodology that utilizes more recent student data. The methodology utilized in previous years was a more conservative approach that resulted in an allowance that was a greater percentage of the outstanding receivables.

Revenue Recognition

Tuition revenue is recognized in the fiscal year in which the substantial portion of the educational term occurs. Revenues for auxiliary enterprises are recognized as the related goods and services are delivered and rendered. Grant revenues are recognized as the eligible grant activities are conducted. Payments received in advance for tuition, goods and services are deferred.

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

TMSHMC has agreements with third-party payors that provide for payments to TMSHMC at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined or such estimates change.

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

Fair Value of Financial Instruments

The University has provided fair value estimates for certain financial instruments in the notes to the financial statements. Fair value information presented in the financial statements is based on information available at June 30, 2009 and 2008. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable are reasonable estimates of their fair value. The carrying values of the amounts of the University's loans to students are also reasonable estimates of their fair value, as the total outstanding loans to students as of June 30, 2009 and 2008 have been made at the rates available to students for similar loans at such times. The fair value of investments is disclosed in Note 3. The fair value of the University's bonds payable is disclosed in Note 7. See Note 5 for discussion of fair value measurements.

Cash Flows

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

	2009	2008
Interest paid	$ 41,495,000	$ 37,583,000
Non-cash acquisitions of land, buildings and equipment	7,150,000	27,651,000

Cash and cash equivalents include certain investments in highly liquid instruments with maturities of 90 days or less, except for such assets held by the University's investment managers as part of their long-term investment strategies. Short-term investments include other current investments held for general operating purposes with maturities greater than three months but less than 12 months.

Inventories

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

Investments

The University's noncurrent investments represent the University's endowment and other investments held for general operating purposes. The University's investments are reported at fair value in the accompanying financial statements. Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair values with gains and losses included in the consolidated statements of activities. The University records derivative securities at market value with changes in market value reflected in the consolidated statements of activities.

The estimated fair value amounts for marketable debt and equity securities held by the University have been reviewed by the University and determined using available market information as supplied by the various financial institutions that act as trustees or custodians for the University. For non-liquid holdings, generally investments in real estate, venture capital and energy limited partnerships, estimated fair value is determined based upon financial information provided by the limited partnerships. 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, 2009 and 2008. Because the limited partnerships are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market existed, and such differences could be material.

Beneficial Interest in Perpetual Trusts

The University receives endowment income from investments of $11,025,000 and $13,673,000 held by outside trustees at June 30, 2009 and 2008, respectively. The fair value of such investments has been recorded as permanently restricted net assets and related beneficial interest in perpetual trusts in the consolidated financial statements.

Investment in Plant

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

	2009	2008
Land	$ 103,108,000	$ 91,506,000
Buildings	3,795,427,000	3,472,408,000
Improvements other than buildings	474,560,000	445,576,000
Equipment	891,909,000	844,274,000
Total plant	5,265,004,000	4,853,764,000
Less accumulated depreciation	(2,294,682,000)	(2,121,020,000)
Total investment in plant, net	$ 2,970,322,000	$ 2,732,744,000

Asset Retirement Obligation

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

Balance as of June 30, 2007	$ 44,248,000
Accretion expense	2,299,000
Liabilities settled	(462,000)
Balance as of June 30, 2008	46,085,000
Accretion expense	2,324,000
Liabilities settled	(1,358,000)
Balance as of June 30, 2009	$ 47,051,000

Conditional asset retirement obligations of $47,051,000 and $46,085,000 are included in other noncurrent liabilities in the consolidated statement of financial position at June 30, 2009 and 2008, respectively.

Accounting Pronouncements

On July 1, 2008, the University adopted the provisions of FASB Statement No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It emphasizes that fair value is a market-based measurement, not an entity-specific measure. Fair value measurement is determined based on the assumptions that market participants would use in pricing an asset or liability including a consideration on non-performance risk. The adoption of this Statement did not have a material effect on the consolidated financial statements for the University. See note 5 for additional information.

In February 2008, the FASB issued FASB Staff Position ("FSP") FAS 157-2, *Effective Date of FASB Statement No. 157* ("FSP 157-2") which delays the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis, at least annually, until fiscal year 2010. The University has not yet determined the impact of FSP 157-2 on the consolidated financial statements. In October 2008, the FASB issued FSP FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active* ("FSP 157-3"), which clarifies the application of SFAS 157 in determining the fair value of an asset in a market that is not active. The effect of adopting FSP 157-3 did not have a material impact on the consolidated financial statements of the University. In April 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* ("FSP 157-4"), which provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. This FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. The effect of adopting FSP 157-4 did not have a material impact on the consolidated financial statements of the University.

On July 1, 2008, the provisions of SFAS 159, *Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement 115* ("SFAS 159") permitted the University to measure many financial assets and liabilities at fair value that are not currently required to be measured at fair value. Non-profit entities that elect the fair value option will report unrealized gains and losses in the excess of revenues and expenses at each subsequent reporting date. The fair value option is elected on an instrument-by-instrument basis, with few exceptions. SFAS 159 amends previous guidance to extend the use of the fair value option to available-for-sale and held-to-maturity securities. The Statement also establishes presentation and disclosure requirements to help financial statement users understand the effect of the election. The University did not elect to measure any financial assets and liabilities at fair value which were not previously required to be measured at fair value. Therefore, the adoption of SFAS 159 did not have an impact on the consolidated financial statements of the University.

On July 1, 2008, the University adopted FSP FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), and Enhanced Disclosures for All Endowment Funds* ("FSP 117-1"). FSP 117-1 is intended to improve quality and consistency of financial reporting of endowments held by not-for-profit organizations. FSP 117-1 provides guidance on classifying the net assets associated with donor-restricted endowment funds held by organizations that are subject to an enacted version of Uniform Prudent Management of Institutional Funds Act of 2006 ("UPMIFA"), which serves as a model act for states to modernize their laws governing donor-restricted funds. FSP 117-1 also requires additional disclosures about endowments (both donor-restricted funds and board-designated funds) for all organizations, including those that are not yet subject to an enacted version of UPMIFA. The adoption of FSP 117-1 did not have a material impact on the University's consolidated financial statements. See note 4 for additional information.

On July 1, 2007, the University adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109"* ("FIN 48"). FIN 48 prescribes the minimum recognition threshold a tax position must meet in connection with accounting for uncertainties in income tax positions taken or expected to be taken by an entity, before being measured and recognized in the financial statements. The adoption of FIN 48 did not have a material impact on the University's financial statements. The University files U.S. federal tax returns. No returns are currently under examination. The statute of limitations on the University's U.S. federal information returns remain open for three years following the year they are filed.

In April 2009, FASB issued FASB Statement No. 164, *Not-For-Profit Entities: Mergers and Acquisitions--Including an amendment of FASB Statement No. 142* ("SFAS 164"). SFAS 164 defines a combination of one or more other not-for-profit entities, business or nonprofit activities as either a merger or acquisition. SFAS 164 establishes principles and requirements in determining whether a not-for-profit entity combination is a merger or acquisition, applies carryover method in accounting for mergers, applies acquisition method in accounting for acquisitions, including which of the combining entities is the acquirer, and requires enhanced disclosures about the merger or acquisition. It also amends FASB Statement No. 142, *Goodwill and Other Intangibles Assets* ("SFAS 142") to make it fully applicable to not-for-profit entities. Furthermore, it amends FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, made to Accounting Research Bulletin ARB No. 51, *Consolidated Financial Statements*, and FASB Statement No. 141(R) *Business Combinations.* SFAS 164 and the amended FASB Statement No. 141(R) *Business Combinations*, SFAS 142, and SFAS 160 are effective for the University beginning July 1, 2010, and may not be applied before that date. The University has not yet determined the impact of these statements on the consolidated financial statements.

In May 2009, FASB issued FASB Statement No. 165, *Subsequent Events* ("SFAS 165"). SFAS 165 is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, whether that date represents the date of the financial statements were issued or were available to be issued. This disclosure should alert all users of financial statements that an entity has not evaluated subsequent events after that date in the financial statements presented. SFAS 165 is effective for the University as of June 30, 2009. In accordance with provisions of SFAS 165, the University has evaluated subsequent events through October 16, 2009, when the financial statements were available for issuance.

In December 2008, FASB approved FASB Staff Position No. 132(R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets* ("FSP-132(R)-1"). FSP-132(R)-1 amends SFAS 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits*, to provide guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. The statement also includes a technical amendment to SFAS 132(R) that requires a nonpublic entity to disclose net periodic benefit cost for each annual period for which a statement of operations is presented. FSP-132(R)-1 is effective for fiscal years ending after December 15, 2009. The University has not yet determined the impact of this statement on the consolidated financial statements.

In June 2009, FASB issued FASB Statement No. 166, *Accounting for Transfer of Financial Assets – an amendment of FASB Statement No. 140* ("SFAS 166"). SFAS 166 clarifies that the objective of paragraph 9 of SFAS 140 is to determine whether a transferor and all of the entities included in the transferor's financial statements being presented have surrendered control over transferred financial assets. That determination must consider the transferor's continuing involvements in the transferred financial asset, including all arrangements or agreements made contemporaneously with, or in contemplation of, the transfer even if they were not entered into at the time of the transfer. SFAS 166 is effective for the year beginning July 1, 2010. The University has not yet determined the impact of this statement on the consolidated financial statements.

Reclassifications

Certain 2008 amounts related to cash and cash equivalents have been reclassified to conform with 2009 presentation within the consolidated statement of financial position. Cash and cash equivalents – in short term operating portfolios and cash and cash equivalents – in operating investment portfolios as presented in the prior year have been combined and presented as cash and cash equivalents to conform to the 2009 presentation.

Certain amounts within the 2008 consolidated statement of activities have been reclassified to conform with 2009 presentation related to the presentation of operating and non-operating activities. The current presentation of the consolidated statement of activities is more reflective of the core operations of the University.

3. INVESTMENTS

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

	2009	2008
Money markets	$ 228,451,000	$ 128,543,000
Fixed income:		
U.S. government/agency	447,040,000	519,374,000
U.S. corporate	394,703,000	593,766,000
Foreign	108,004,000	118,866,000
Other	285,384,000	617,030,000
Equities	588,043,000	856,353,000
Private capital	439,066,000	530,714,000
Investments held under securities lending program	253,696,000	265,725,000
Total	$2,744,387,000	$3,630,371,000

Other fixed income investments consist of collateralized mortgage obligations, mortgage-backed securities, asset-backed securities and municipal bonds. Equity investments are comprised of domestic and foreign common stocks. Private capital consists primarily of interests in real estate, private equity, venture capital, energy and hedge fund limited partnerships. To conform to the presentation of cash and cash equivalents within the 2009 consolidated statement of financial position, $78,229,000 of cash and cash equivalents – operating investment portfolios has been removed from the 2008 presentation of investments by major category.

The following schedules summarize the investment return and its classification in the consolidated statement of activities for the years ended June 30, 2009 and June 30, 2008:

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

2008	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Dividends and interest	$ 98,359,000	$ 6,907,000	$ 9,382,000	$ 114,648,000
Net realized gains	57,189,000	21,238,000	29,000	78,456,000
Net unrealized losses	(94,696,000)	(119,622,000)	-	(214,318,000)
Total returns	$ 60,852,000	$ (91,477,000)	$ 9,411,000	$ (21,214,000)

In the management of investments, the University authorizes certain of its investment managers to purchase derivative securities to attain a desired market position; and the University may directly invest in derivative securities to attain a desired market position. The University does not trade or issue derivative financial instruments other than through the investment management practices noted above. Gains and losses from derivative instruments are reported in the consolidated statements of activities. Futures contracts, which are fully cash collateralized, are marked to market daily and are included in the carrying value of the University's investments. The market value of all derivative instruments is included in the market value of the University's investments. Futures contracts have minimal credit risk because the counterparties are the exchanges themselves. Fully cash collateralized derivative securities comprised approximately 1.6% and 2.8% of total investments at June 30, 2009 and 2008.

Through an agreement with its primary investment custodian, the University participates in lending securities to brokers. Collateral is generally limited to cash, government securities, and irrevocable letters of credit. Both the investment custodian and the security borrowers have the right to terminate a specific loan of securities at any time. The University receives lending fees and continues to earn interest and dividends on the loaned securities. At June 30, 2009 and 2008, the University held $253,696,000 and $265,725,000, respectively, of cash and cash equivalents as collateral deposits for the securities lending program. The collateral is included as an asset and the obligation to return such collateral is presented as a liability in the consolidated statements of financial position. The securities on loan had an estimated fair value of $249,278,000 and $261,096,000 at June 30, 2009 and 2008, respectively.

4. ENDOWMENT NET ASSETS

The University's endowment includes both donor-restricted endowment funds and funds designated to function as endowments. As required by generally accepted accounting principles ("GAAP"), net assets associated with endowment funds, including funds designated to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions. As discussed in note 2, the University has adopted FSP 117-1. The enhanced disclosures related to the net asset classification and changes in endowment net assets required by FSP 117-1 have been incorporated in the following tables.

The Commonwealth of Pennsylvania has not adopted UPMIFA but rather is subject to Pennsylvania Act 141 ("PA Act 141"). PA Act 141 permits an organization's trustees to define income as a stipulated percentage of endowment assets (between 2% and 7% of the fair value of the assets averaged over a period of at least three preceding years) without regard to actual interest, dividend, or realized and unrealized gains.

The University has interpreted PA Act 141 to permit the University to spend the earnings of its endowment based on a total return approach, without regard to the fair value of the original gift. As a result of this interpretation, the University classifies as permanently restricted net assets the original value of gifts donated to the permanent endowment, the original value of subsequent gifts to the permanent endowment, and accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by PA Act 141. Funds functioning as endowments are classified as unrestricted net assets due to the lack of external donor restrictions. Gains and losses attributable to permanent endowments are recorded as temporarily restricted net assets and gains and losses attributable to funds functioning as endowments are recorded as unrestricted net assets.

From time to time due to unfavorable market fluctuations, the fair value of some assets associated with individual donor-restricted endowment funds may fall below the level that donors require to be retained as a perpetual fund, while other assets are unaffected to the same extent and maintain or exceed the level required. The aggregate amount of deficiencies at June 30, 2009 was $59,653,000, 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. Aggregate deficiencies as of June 30, 2008 amounted to $1,664,000.

Endowment net asset composition by type of fund as of June 30, 2009 and 2008:

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

2008	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ -	$ 359,229,000	$ 754,469,000	$ 1,113,698,000
Funds functioning as endowments	409,290,000	-	-	409,290,000
Total net assets	$ 409,290,000	$ 359,229,000	$ 754,469,000	$ 1,522,988,000

Changes in endowment net assets for the years ended June 30, 2009 and 2008:

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

2008	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of the year	$ 435,712,000	$441,090,000	$ 710,395,000	$1,587,197,000
Endowment return:				
Endowment earnings	29,554,000	-	2,656,000	32,210,000
Net realized gains	39,399,000	22,265,000	-	61,664,000
Net unrealized losses	(38,735,000)	(104,145,000)	-	(142,880,000)
Total endowment return	30,218,000	(81,880,000)	2,656,000	(49,006,000)
Contributions	-	19,000	41,418,000	41,437,000
Endowment spending	(60,390,000)	-	-	(60,390,000)
Transfers to create funds functioning as endowments	3,750,000	-	-	3,750,000
Endowment net assets, end of the year	$ 409,290,000	$359,229,000	$ 754,469,000	$1,522,988,000

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

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

The University has a policy of appropriating for distribution each year a certain percentage (4.8% for 2009) of its pooled endowment fund's average fair market value over the prior five years through December 31 preceding the fiscal year in which the distribution is planned. Accordingly, over the long term, the University expects the current spending policy to allow its endowment to provide generous current spending while preserving "intergenerational equity". This is consistent with the University's objective to maintain the purchasing power of the endowment assets held in perpetuity as well as to provide additional real growth through new gifts and investment returns.

5. FAIR VALUE MEASUREMENTS

The University adopted SFAS No. 157, *Fair Value Measurements* on July 1, 2008. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements.

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

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets as of the measurement date;

Level 2 – Other observable inputs, either directly or indirectly, including:

- Quoted prices for similar assets in active markets;
- Quoted prices for identical or similar assets in non-active markets (few transactions, limited information, non-current prices, high variability over time, etc.);
- Inputs other than quoted prices that are observable for the asset (interest rates, yield curves, volatilities, default rates, etc.); and
- Inputs that are derived principally from or corroborated by other observable market data.

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, 2009 about the University's financial assets and liabilities that are measured at fair value on a recurring basis:

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

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

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

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

6. CONTRIBUTIONS RECEIVABLE

Contributions receivable are summarized as follows as of June 30:

	2009	2008
In one year or less	$ 65,905,000	$ 51,814,000
Between one year and five years	79,949,000	67,557,000
More than five years	93,923,000	89,864,000
	239,777,000	209,235,000
Less allowance	(9,779,000)	(10,578,000)
Less discount	(52,939,000)	(52,958,000)
Contributions receivable, net	$ 177,059,000	$ 145,699,000

At June 30, 2009 and 2008, the University has received bequest intentions and certain other conditional promises to give of $34,107,000 and $31,328,000, respectively. These intentions and conditional promises to give are not included in the consolidated financial statements.

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

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

7. LONG-TERM DEBT

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

	2009	2008
The Pennsylvania State University Bonds		
Series 2009A	$ 138,060,000	$ -
Series 2009B	74,235,000	-
Series 2008A	77,670,000	77,670,000
Series 2008B	7,460,000	8,310,000
Series 2007A	90,110,000	90,570,000
Series 2007B	73,810,000	76,120,000
Series 2005	93,165,000	94,885,000
Series 2004A	57,730,000	58,845,000
Refunding Series 2003	22,355,000	24,350,000
Series of 2002	100,000,000	100,000,000
Refunding Series 2002	96,945,000	112,240,000
Refunding Series 2001	18,140,000	26,565,000
Series A of 2001	-	75,000,000
Pennsylvania Higher Educational Facilities Authority University Revenue Bonds (issued for The Pennsylvania State University)		
Series 2006	4,305,000	4,480,000
Series 2004	4,810,000	5,015,000
Series 2002	5,365,000	5,670,000
Lycoming County Authority College Revenue Bonds (issued for Penn College)		
Series 2008	55,000,000	55,000,000
Series 2005	14,035,000	14,645,000
Series 2003	-	3,315,000
Series 2002	29,300,000	29,650,000
Series 2000	39,370,000	39,370,000
Series 1993	13,940,000	12,519,000
Total bonds payable	1,015,805,000	914,219,000
Unamortized bond premiums	36,717,000	27,231,000
Notes payable and capital leases		
Demand note payable	-	10,000,000
Note payable	4,000,000	-
Capital lease obligations	75,917,000	71,412,000
Total notes payable and capital leases	79,917,000	81,412,000
Total long-term debt	$1,132,439,000	$1,022,862,000

The Pennsylvania State University Bonds

- Series 2009A and 2009B – general obligation bonds issued in May 2009 and June 2009, respectively, for the purpose of funding various construction and renovation projects and for the current refunding of the Series A of 2001 Bonds. The University, in conjunction with the issuance of the Series 2009B Bonds, legally defeased the Series A of 2001 Bonds, with an outstanding principal of $75,000,000. As a result of the current refunding transaction, amounts related to the Series A of 2001 Bonds have been removed from the University's June 30, 2009 consolidated statement of financial position. Principal payments on the Series 2009A Bonds are due annually, in amounts ranging from $5,540,000 to $9,320,000 through March 2029. The principal amount of the Series 2009B Bonds is due June 2031. The Series 2009A Bonds pay interest at rates ranging from 2.00% to 5.00%. The Series 2009A Bonds are subject to early redemption provisions, at the option of the University, beginning March 2019. The Series 2009B Bonds are currently paying interest on a variable rate basis at a long term rate for an initial long term period commencing on the date of issuance and ending May 2010; 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 1.50% with adjustment on the respective date to the rate the remarketing agent believes will cause the bonds to have a market value equal to the principal amount up to a maximum of 12%. The 2009B bondholders have the right to tender bonds on the purchase dates while such bonds bear interest at the daily, weekly or monthly rate. The 2009B Bonds were issued subject to the self-liquidity program established by the University on the date of issuance pursuant to which the University will provide liquidity for the 2009B Bonds from its general funds in the event of insufficient remarketing proceeds.

- Series 2008A and 2008B – general obligation bonds issued in April 2008 for the purpose of funding various construction and renovation projects and for the current refunding of the Series 1997B Bonds, which previously refunded the Series 1992B Bonds. The University, in conjunction with the issuance of the Series 2008B bonds, legally defeased the Series B of 1997 Bonds, with an outstanding principal of $8,105,000, by irrevocably depositing $8,364,000 in an escrow fund to be used to pay the interest accrued, maturing principal on and the redemption price of the refunded bonds. As a result of the current refunding transaction, amounts related to the Series 1997B Bonds were removed from the University's June 30, 2008 statement of financial position. Principal payments on the Series 2008A and 2008B bonds are due annually, in amounts ranging from $830,000 to $7,695,000 through August 2029. The bonds pay interest at rates ranging from 3.00% to 5.00%. The 2008A Bonds are subject to early redemption provisions, at the option of the University, beginning February 2018.

- Series 2007A and 2007B – general obligation bonds issued in January 2007 for the purpose of funding various construction and renovation projects and for the advance refunding of the Series 1997A Bonds. The University, in conjunction with the issuance of the Series 2007B bonds, legally defeased the Series A of 1997 Bonds, with an outstanding principal of $84,540,000, by irrevocably depositing $88,341,000 in an escrow fund to be used to pay the interest accrued, maturing principal on and the redemption price of the refunded bonds. Principal payments on the Series 2007A and 2007B bonds are due annually, in amounts ranging from $2,885,000 to $5,955,000 through August 2027, with additional payments of $11,115,000 due August 2028 and $70,905,000 due August 2036. The bonds pay interest at rates ranging from 3.60% to 5.25% and are subject to sinking fund redemption beginning August 2023 and early redemption provisions, at the option of the University, beginning August 2016.

- Series 2005 – general obligation bonds issued in January 2005 for the purpose of funding various construction projects. Principal payments are due annually in amounts ranging from $1,770,000 to $2,745,000 through September 2019, with additional payments of $15,990,000, $20,550,000 and $32,485,000 due September 2024, 2029 and 2034, respectively. The bonds pay interest at rates ranging from 3.00% to 5.00% and are subject to sinking fund redemption beginning September 2020 and early redemption provisions, at the option of the University, beginning September 2015.

- Series 2004A – general obligation bonds issued in April 2004 for the purpose of funding various construction projects. Principal payments are due annually in amounts ranging from $1,150,000 to $1,825,000 through September 2019, with additional payments of $10,625,000, $13,635,000 and $17,515,000 due September 2024, 2029 and 2034, respectively. The bonds pay interest at rates ranging from 3.00% to 5.00% and are subject to sinking fund redemption beginning September 2020 and early redemption provisions, at the option of the University, beginning September 2014.

- Refunding Series 2003 – general obligation bonds issued in March 2003 for the purpose of refunding the Refunding Series 1993A and to pay costs associated with issuing the 2003 Refunding Bonds. Principal payments are due annually in amounts ranging from $2,075,000 to $2,970,000 through March 2018. The bonds pay interest at rates ranging from 3.25% to 5.25% and are subject to early redemption provisions, at the option of the University, beginning March 2013.

- Series of 2002 – general obligation bonds issued in May 2002 for the purpose of funding a portion of the costs of the acquisition, construction, equipping, renovation and improvement of certain facilities of the University. The bonds are currently paying interest on a variable rate basis; however, the University has the option to convert to another variable rate or to a fixed rate basis (such rates are generally determined on a market basis). The bonds currently pay interest at .45% with adjustment on a weekly basis to the rate the remarketing agent believes will cause the bonds to have a market value equal to the principal amount up to a maximum of 12%. The bondholders have the right to tender bonds at interest rate reset dates. The University, therefore, entered into standby bond purchase agreements with banks to provide liquidity in case of tender. The principal amount of the bonds is due March 2032. The bonds are not subject to sinking fund redemption; however, the University has the option to redeem the bonds prior to their scheduled maturity.

- Refunding Series 2002 – general obligation bonds issued in May 2002 for the purpose of refunding the Second Refunding 1992A Series (such bonds were previously issued to refund the Second Refunding 1988 Series, 1989 Series and 1991 Series Bonds). Principal payments are due annually, in amounts ranging from $4,585,000 to $16,540,000 through August 2016. The bonds pay interest at rates ranging from 4.79% to 5.25%. The bonds are not subject to redemption prior to maturity.

- Refunding Series 2001 – general obligation bonds issued in December 2001 for the purpose of refunding the Refunding Series 1992 Bonds (such bonds were previously issued to refund the 1986 Series and the First Refunding Series of 1988 Bonds). Principal payments are due annually, in amounts ranging from $8,850,000 to $9,290,000 through March 2011. The bonds pay interest at rates ranging from 5.00% to 5.25%. The bonds are not subject to redemption prior to maturity.

<u>Pennsylvania Higher Educational Facilities Authority University Revenue Bonds (issued for The Pennsylvania State University)</u>

- Series 2006 – Pennsylvania Higher Educational Facilities Authority (PHEFA) University Revenue Bonds issued by the Pennsylvania State University in April 2006 for the purpose of funding the costs of sprinkler system installation and repairs in certain of the University's dormitories during the period 2006-2008, related design costs and payment of issuance costs. Principal payments are due annually in amounts ranging from $180,000 to $280,000 through September 2020, with an additional payment of $1,610,000 due September 2025. The bonds pay interest at rates ranging from 3.70% to 5.125%, with PHEFA subsidizing the annual interest cost to the University for interest rates greater than 3.00%. The bonds are subject to sinking fund redemption beginning September 2021 and early redemption provisions, at the option of the University, beginning September 2016.

- Series 2004 – Pennsylvania Higher Educational Facilities Authority University Revenue Bonds issued by the Pennsylvania State University in May 2004 for the purpose of funding the costs of sprinkler system installation and repairs in certain of the University's dormitories during 2004-2005. Principal payments are due annually in amounts ranging from $215,000 to $325,000 through September 2019, with an additional payment of $1,905,000 due September 2024. The bonds pay interest at rates ranging from 3.40% to 5.00%, with PHEFA subsidizing the annual interest cost to the University for interest rates greater than 3.00%. The bonds are subject to sinking fund redemption beginning September 2020 and early redemption provisions, at the option of the University, beginning September 2014.

- Series 2002 – Pennsylvania Higher Educational Facilities Authority University Revenue Bonds issued by the Pennsylvania State University in June 2002 for the purpose of funding the costs of sprinkler system installation and repairs in certain of the University's dormitories during the period 2002 through 2004. Principal payments are due annually in amounts ranging from $315,000 to $425,000 through March 2017, with an additional payment of $2,435,000 due March 2022. The bonds pay interest at rates ranging from 3.90% to 5.00%, with PHEFA subsidizing the annual interest cost to the University for interest rates greater than 3.00%. The bonds are subject to sinking fund redemption beginning March 2018 and early redemption provisions, at the option of the University, beginning March 2011.

<u>Lycoming County Authority College Revenue Bonds (issued for Penn College)</u>

- Series 2008 – Lycoming County Authority College Revenue Bonds issued by Penn College in February 2008 for the purpose of funding various construction projects at the Penn College campus. Principal payments are due annually in amounts ranging from $1,455,000 to $4,140,000 through October 2037. The bonds pay interest at rates ranging from 3.50% to 5.50%.

- Series 2005 – Lycoming County Authority College Revenue Bonds issued by Penn College in February 2005 for the purpose of refunding $7,765,000 of the Authority's College Bonds, Series of 1997, funding a deposit into the debt service reserve account, funding various construction and renovation projects and payment of costs of issuance of 2005 Bonds. Principal payments are due annually in amounts ranging from $500,000 to $1,855,000 through January 2025. The bonds pay interest at rates ranging from 3.00% to 5.00%.

- Series 2003 – Lycoming County Authority College Revenue Bonds issued by Penn College in February 2003 for the purpose of refunding $17,385,000 of the Authority's College Revenue Bonds, Series of 1993 and the payment of costs of issuance of 2003 Bonds. These bonds were paid in full during 2009.

- Series 2002 – Lycoming County Authority College Revenue Bonds issued by Penn College in May 2002 for the purpose of funding various construction projects at the Penn College campus. Principal payments are due annually in amounts ranging from $370,000 to $2,775,000 through May 2032. The bonds pay interest at rates ranging from 4.20% to 5.25%.

- Series 2000 – Lycoming County Authority College Revenue Bonds issued by Penn College in December 2000 for the purpose of funding various construction projects, refunding the 1996 Lycoming County Authority College Revenue Bonds, advance refunding $4,235,000 of the 1997 Lycoming County Authority College Revenue Bonds (1997 Series Bonds), funding of a deposit to the debt service fund reserve account established under the indenture and payment of the costs of issuance of the Series 2000 Bonds. Principal payments are due annually in amounts ranging from $30,000 to $5,225,000 through July 2030. The bonds pay interest at rates ranging from 4.75% to 5.50%.

- Series 1993 – Lycoming County Authority College Revenue Bonds issued by Penn College in 1993 for the purpose of undertaking a series of capital improvement projects. Principal payments are due annually in amounts ranging from $450,000 to $1,302,000 through November 2015. The bonds pay interest at rates ranging from 6.00% to 6.15%.

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

Year	Annual Installments
2010	$ 42,060,000
2011	40,945,000
2012	33,405,000
2013	35,035,000
2014	40,325,000
Thereafter	824,035,000

The fair value of the University's bonds payable is estimated based on current rates offered for similar issues with similar security, terms and maturities using available market information as supplied by the various financial institutions who act as trustees or custodians for the University. At June 30, 2009, the carrying value and estimated fair value of the University's bonds payable, including issuance premiums, are $1,052,522,000 and $1,053,279,000, respectively. At June 30, 2008, the carrying value and estimated fair value of the University's bonds payable, including issuance premiums, were $941,450,000 and $934,952,000, respectively. Certain bond issues have associated issuance premiums, these issuance premiums total $36,717,000 and $27,231,000 at June 30, 2009 and 2008, 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.

Notes payable and capital leases

A $4,000,000 note payable with principal payments due in two equal installments in May 2010 and 2011, respectively is included within the consolidated statements of financial position at June 30, 2009. A $10,000,000 demand note payable bearing interest at a variable rate (3.00% at June 30, 2008) is included at June 30, 2008 in the current portion of long-term debt within the consolidated statements of financial position. This note was paid in full during 2009.

The University has certain lease agreements in effect which are considered capital leases that are included as long-term debt in the statements of financial position. These leases have been capitalized at the net present value of the minimum lease payments. The capitalized cost and accumulated depreciation of the leases at June 30, 2009 and 2008 was $90,298,000 and $15,735,000, and $82,870,000 and $10,753,000, respectively. Future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of June 30, 2009 are as follows:

Year	
2010	$ 9,732,000
2011	9,657,000
2012	9,209,000
2013	8,167,000
2014	6,895,000
Thereafter	159,338,000
Total minimum lease payments	202,998,000
Less imputed interest	(127,081,000)
Capital lease obligation	75,917,000
Current portion	5,250,000
Long-term portion	$ 70,667,000

The University has entered into a Master Building Sublease with ADG - Hospital Drive Associates ("ADG-HDA"), a limited partnership (of which the University maintains a 75% interest, carried at $1,679,000 and $1,489,000 in investments at June 30, 2009 and 2008, respectively), which required ADG-HDA to construct the Centre Medical Sciences Building ("Building") and lease it to the University for an initial term of twenty-five years. The Building was constructed on land jointly owned by the University and Mount Nittany Medical Center, which has been leased by ADG-HDA for a term of sixty years. The University has subleased portions of the Building to the Mount Nittany Medical Center and other healthcare related entities.

8. OPERATING LEASES

The University has certain lease agreements in effect which are considered operating leases. During the year ended June 30, 2009, the University recorded expenses of $20,981,000 for leased equipment and $17,476,000 for leased building space. During the year ended June 30, 2008, the University recorded expenses of $22,481,000 for leased equipment and $15,619,000 for leased building space.

Future minimum lease payments under operating leases as of June 30, 2009 are as follows:

Year	
2010	$ 22,153,000
2011	17,883,000
2012	13,700,000
2013	11,307,000
2014	10,064,000
Thereafter	67,627,000
Total minimum lease payments	$142,734,000

9. RETIREMENT BENEFITS

The University provides retirement benefits for substantially all regular employees, primarily through either contributory defined benefit plans administered by the Commonwealth of Pennsylvania State Employees' Retirement System and The Public School Employees' Retirement System or defined contribution plans administered by the Teachers Insurance and Annuity Association – College Retirement Equity Fund and Fidelity Investments. The University is billed for its share of the estimated actuarial cost of the defined benefit plans ($11,386,000 and $10,614,000 for the years ended June 30, 2009 and 2008, respectively). The University's total cost for retirement benefits, included in expenses, is $107,569,904 and $99,263,000 for the years ended June 30, 2009 and 2008, respectively.

10. POSTRETIREMENT BENEFITS

The University sponsors a retiree medical plan covering eligible retirees and eligible dependents. For the 2009 benefit plan year, this program includes a Preferred Provider Organization ("PPO") plan for retirees and their dependents who are not eligible for Medicare, a Medicare Advantage Private Fee For Service ("PFFS") plan and a Medicare Supplement plan. In addition, the University provides retiree life insurance benefits of $5,000 at no cost to the retiree. A limited number of retirees have $10,000 of life insurance coverage; $5,000 of which is provided by the University and $5,000 is paid by the retiree.

Retirees are eligible for medical coverage and life insurance after they retire if:

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

OR

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

The retiree PPO medical plan and the $5,000 life insurance coverage are self-funded programs, and all medical claims, death benefits and other expenses are paid from the unrestricted net assets of the University. The PFFS plan and the Medicare Supplement plan are fully insured. The retirees pay varying amounts for coverage under the medical plan. As of January 1, 2009, the monthly amounts ranged from $12 to $247 depending on age and dependent coverage options selected.

Included in unrestricted net assets at June 30, 2009 and 2008 are the following amounts that have not yet been recognized in net periodic postretirement cost: unrecognized prior service cost (benefit) of ($172,502,000) and ($194,389,000) and unrecognized actuarial loss of $367,969,000 and $334,646,000, respectively.

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

Change in benefit obligation:

	2009	2008
Benefit obligation at the beginning of year	$ 924,337,000	$ 834,562,000
Service cost	38,189,000	32,882,000
Interest cost	60,261,000	53,390,000
Actuarial loss	53,026,000	32,793,000
Benefits paid	(31,887,000)	(29,290,000)
Plan amendment	259,000	-
Benefit obligation at end of year	$ 1,044,185,000	$ 924,337,000

Change in plan assets:

	2009	2008
Fair value of plan assets at beginning of year	$ -	$ -
Employer contributions	31,887,000	29,290,000
Benefits paid	(31,887,000)	(29,290,000)
Fair value of plan assets at end of year	$ -	$ -
Funded status	$(1,044,185,000)	$ (924,337,000)
Unrecognized prior service cost (benefit)	-	-
Unrecognized net actuarial loss	-	-
Accrued postretirement benefit expense	$(1,044,185,000)	$ 924,337,000)

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

	2009	2008
Service cost	$ 38,189,000	$ 32,882,000
Interest cost	60,261,000	53,390,000
Amortization of prior service cost	(21,629,000)	(21,629,000)
Amortization of unrecognized net loss	19,705,000	17,766,000
Net periodic postretirement cost	$ 96,526,000	$ 82,409,000

The assumed healthcare cost trend rate used in measuring the accumulated postretirement benefit obligation was 8.50% and 9.00% for the 2008-2009 and 2007-2008 plan years, respectively, reduced by 0.50% per year to a fixed level of 5.00%. The weighted average postretirement benefit obligation discount rate was 6.25% for each of the years ended June 30, 2009 and 2008, respectively.

If the healthcare cost trend rate assumptions were increased by 1% in each year, the accumulated postretirement benefit obligation would be increased by $178,092,000 and $160,053,000 as of June 30, 2009 and 2008, 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 $20,225,000 and $17,951,000 as of June 30, 2009 and 2008, respectively. If the healthcare cost trend rate assumptions were decreased by 1% in each year, the accumulated postretirement benefit obligation would be decreased by $142,673,000 and $127,972,000 as of June 30, 2009 and 2008, 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 $15,759,000 and $13,958,000 as of June 30, 2009 and 2008, 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:

2010	40,365,000
2011	43,202,000
2012	45,682,000
2013	47,945,000
2014	50,571,000
2015-19	296,933,000

11. THE MILTON S. HERSHEY MEDICAL CENTER

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

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 $525,065,000 of which $323,952,000 has been paid or accrued as of June 30, 2009. The contract costs are being financed from available resources and from borrowings.

Under the terms of certain limited partnership agreements, the University is obligated to periodically advance additional funding for private equity and real estate investments. The University has unfunded commitments of approximately $252,823,000 as of June 30, 2009 for which capital calls have not been exercised. Such commitments generally have fixed expiration dates or other termination clauses. The University maintains sufficient liquidity in its investment portfolio in the event that such calls are exercised.

Letters of Credit

The University has outstanding letters of credit in the amount of $13,878,000 and $15,404,000 as of June 30, 2009 and 2008, 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.

Self-Insurance

The University has a coordinated program of commercial and self-insurance for medical malpractice claims at TMSHMC through the use of a qualified trust and a domestic captive insurance company in combination with a self-insured retention layer and is supplementing this program through participation in the Pennsylvania Medical Care Availability and Reduction of Error Fund ("Mcare Fund"), formerly the Pennsylvania Medical Professional Liability Catastrophe Loss Fund ("CAT Fund"), in accordance with Pennsylvania law. An estimate of the present value, discounted at 4%, of the medical malpractice claims liability in the amount of $67,988,000 and $74,234,000 is recorded as of June 30, 2009 and 2008, respectively.

On July 1, 2003, TMSHMC became self-insured for all medical malpractice claims asserted on or after July 1, 2003, for all amounts that are below the coverage of the TMSHMC's excess insurance policies and not included in the insurance coverage of the Mcare Fund. Under the self-insurance program, TMSHMC is required to maintain a malpractice trust fund in an amount at least equal to the expected loss of known claims. The balance of this trust fund was $17,764,000 and $24,648,000 at June 30, 2009 and 2008, respectively. TMSHMC intends to fund any claims due during the next year from cash flows from operations.

With approval from the Pennsylvania Department of Labor and Industry ("PA-DLI"), the University elected to self-insure potential obligations applicable to workers' compensation. Certain claims under the program are contractually administered by a private agency. The University purchased insurance coverage for excess obligations over $600,000 per incident. An estimate of the self-insured workers' compensation claims liability in the amount of $13,243,000 and $11,081,000, discounted at 1.25%, is recorded as of June 30, 2009 and 2008, respectively. The University has established a trust fund, in the amount of $11,590,000 and $11,001,000 at June 30, 2009 and 2008, respectively, as required by PA-DLI, to provide for the payment of claims under this self-insurance program. TMSHMC is self-insured for workers' compensation claims and has purchased an excess policy through a commercial insurer which covers individual claims in excess of $500,000 per incident for workers' compensation claims.

The University and TMSHMC are self-insured for certain health care benefits provided to employees. The University and TMSHMC have purchased excess policies which cover employee health benefit claims in excess of $500,000 and $300,000 per employee per year, respectively. The University and TMSHMC provide for reported claims and claims incurred but not reported.

Litigation and Contingencies

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

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

13. SUBSEQUENT EVENT

On October 9, 2009, the Commonwealth of Pennsylvania adopted a General Fund budget for the 2009-2010 fiscal year. The Pennsylvania State University appropriation is part of the Commonwealth's non-preferred appropriation and is approved under separate legislation that has not yet been passed. Although it is anticipated the University's appropriation will include retroactive American Recovery & Reinvestment Act ("ARRA") funding totaling $16,973,000 for the 2008-2009 fiscal year, these ARRA funds have not been included in the accompanying consolidated financial statements.

THE PENNSYLVANIA STATE UNIVERSITY

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