FINANCIAL STATEMENTS
JUNE 30, 2010

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PENNSYLVANIA STATE SYSTEM OF HIGHER EDUCATION
FINANCIAL STATEMENTS
JUNE 30, 2010

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ParenteBeard

INDEPENDENT AUDITORS' REPORT

Board of Governors
Pennsylvania State System of Higher Education:

We have audited the accompanying financial statements of the Pennsylvania State System of Higher Education, Commonwealth of Pennsylvania ("PASSHE") (a component unit of the Commonwealth of Pennsylvania) and its aggregate discretely presented component units as of and for the years ended June 30, 2010 and 2009, which collectively comprise PASSHE's basic financial statements as listed in the accompanying table of contents. These financial statements are the responsibility of PASSHE's management. Our responsibility is to express an opinion on these financial statements based on our audits. We have audited the financial statements of certain of the discretely presented component units which statements reflect total assets of $300,925,000 and $87,022,000 as of June 30, 2010 and 2009. We did not audit the financial statements of the other aggregate discretely presented component units. Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for the aggregate discretely presented component units, is based on the reports of the other auditors.

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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of PASSHE and of its aggregate discretely presented component units as of June 30, 2010 and 2009, and the respective changes in financial position and cash flows, where applicable, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis (MD&A) on pages 3 through 8 and the Required Supplementary Information on page 30 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

ParenteBeard LLC

Wilkes-Barre, Pennsylvania
September 30, 2010

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Unaudited)

As the public Universities of the Commonwealth of Pennsylvania (Commonwealth), the 14 Universities of the Pennsylvania State System of Higher Education (PASSHE) are charged with providing high quality education at the lowest possible cost to the students. With nearly 117,000 students enrolled, PASSHE is the state's largest higher education provider. Its 14 Universities offer more than 250 degree and certificate programs in more than 120 areas of study. The Universities function independently, but being part of PASSHE enables them to share resources and benefit from economies of scale. Following is an overview of PASSHE's combined financial activities for the year ended June 30, 2010, as compared to the year ended June 30, 2009.

FINANCIAL HIGHLIGHTS

- In fiscal year 2009/10, PASSHE received $465.2 million in General Fund **appropriations** from the Commonwealth, equivalent to the General Fund appropriations received in fiscal year 2005/06, a decrease of $32.0 million, or 6.4%, from fiscal year 2008/09.

- The Commonwealth also appropriated to PASSHE $65.2 million of federal funds from the **American Recovery and Reinvestment Act (ARRA)** State Fiscal Stabilization Funds program in fiscal year 2009/10, comprising $38.1 million of fiscal year 2009/10 ARRA funds and $27.1 million of fiscal year 2008/09 ARRA funds not previously allocated.

- The Commonwealth eliminated PASSHE's fiscal year 2009/10 Realty Transfer Tax allocation from the **Keystone Recreation, Park and Conservation (Key '93) Fund**. These funds, which totaled $13.9 million in fiscal year 2008/09, had provided a consistent revenue stream for deferred maintenance projects since 1993.

- Taking into account Key '93 funds and both years of ARRA funds, the **combined Commonwealth General Fund appropriation** in fiscal year 2009/10 totaled $530.4 million, an increase or $19.4 million, or 3.8%, from fiscal year 2008/09.

- Since 2001, the Commonwealth has provided capital funding of approximately $65 million annually for construction projects on PASSHE campuses. In February 2009, the Governor committed to doubling the **Commonwealth's capital funding** for construction projects on PASSHE campuses to $130 million annually, including an additional $15.2 million for fiscal year 2008/09 to jump-start projects intended for construction in fiscal year 2009/10. Most of this funding is for University land and buildings that are owned by the Commonwealth and not reflected in these statements. The increased investment in Commonwealth facilities on PASSHE campuses is helping PASSHE to manage its deferred maintenance backlog and keep facilities current with technology and modern teaching methods, while enhancing PASSHE's ability to attract, retain, and educate students. The portion of capital appropriations reflected in these statements, representing the furnishings and equipment for the Commonwealth-funded construction projects, totaled $2.4 million, a decrease of $9.3 million from the prior year.

- As part of its continuing commitment to reward the Universities for demonstrating success and continued improvement in student achievement, University excellence, and operational efficiency, the Board allocated 8.0%, or $35.6 million, of the base E&G appropriation for **performance funding** in fiscal year 2009/10.

- PASSHE continues to experience record **enrollment** growth. In fall 2009, enrollment was up for the thirteenth straight year, increasing 3.85% from fall 2008 to 116,935, the highest level in PASSHE's history.

- In March 2010, PASSHE embraced **work force planning** to ensure the proper alignment of human and fiscal resources with the strategic directions and operational responsibilities of the System. Recognizing the challenging economic conditions, with annual work force cost increases outpacing anticipated revenue increases, PASSHE implemented a voluntary separation incentive program during the spring of 2010. This program had two components: the Voluntary Retirement Incentive

Program offered a cash incentive payout to encourage retirement-eligible employees to retire; the Severance for Abolished Positions Program provided a lump sum payout for employees not eligible for retirement but whose positions were abolished. Although the Association of Professional State College and University Faculties (APSCUF) union declined to participate in the Voluntary Retirement Incentive Program, and both APSCUF and the State College and University Professional Association (SCUPA) unions declined to participate in the Severance for Abolished Positions Program, this initiative was highly successful. Over 285 positions were vacated, of which approximately 30% are anticipated to be eliminated. The costs of the cash incentives and associated Social Security and Medicare taxes in fiscal year 2009/10 were $3.7 million. Additional costs will be incurred through September 30, 2010, the program termination date. It is expected that annual cost savings, due to fewer positions and replacements at lower compensation levels, will begin to be realized in fiscal year 2011/12.

- PASSHE's Board of Governors (Board) approved a tuition rate increase of 3.7% for undergraduate resident students in fiscal year 2009/10. Mandatory student fees set by the Universities increased, on average, by 6.0%. These tuition and fee increases, combined with the increase in enrollment, resulted in tuition and fee revenue (before discounts) of $866.7 million, an increase of $73.3 million, or 9.2%, from fiscal year 2008/09. In addition, the most common room and board fees set by the Universities increased 9.7% and 6.0%, respectively, resulting in revenue of $225.1 million, an increase of $2.7 million, or 1.2%, from fiscal year 2008/09.

- Fiscal year 2009/10 was the **first in five years** that PASSHE's tuition increased greater than the rate of inflation—a record no other public university system in the nation can match. Annual tuition increases typically have been anywhere from one-half to one-third the national average at other four-year public colleges and universities.

- Over the last ten years, PASSHE's overall **tuition and required fee increases have been the lowest** among all public college and university systems in the United States, according to a study by the Washington Higher Education Coordinating Board. A separate report issued this fall by the College Board indicates that the average total cost of attending a PASSHE University, including tuition, required fees, room and board, is $564 below the national average and $2,498 below the average charged by other four-year public colleges and universities in the Middle Atlantic region of the United States.

- PASSHE purchased $234.8 million in **capital assets** in fiscal year 2009/10, including $200.1 million to build or improve academic and auxiliary facilities across all 14 Universities.

- During fiscal year 2009/10, PASSHE issued Series AJ **bonds** totaling $124.0 million to provide funds to undertake various capital projects at the Universities, including $27.3 million for academic facilities renovations, $8.2 million for student residences, $4.3 million for student dining facilities, $23.7 million for student union and recreation centers, $38.6 million for guaranteed energy savings agreements, $19.3 million for a parking garage, and $2.6 million for infrastructure. In addition, PASSHE issued Series AK bonds, totaling $47.3 million, to refund Series R and advance refund the Series S revenue bonds. This refunding was completed to reduce debt service by approximately $5.0 million and resulted in an economic gain (difference between the present values of the old and new debt service payments) of approximately $4.8 million. During the year, $38.4 million of principal and $39.4 million of interest was paid, bringing the total outstanding bond debt to $825.4 million at June 30, 2010. In June 2010, Moody's Investors Service, Inc., assigned PASSHE a bond rating of Aa2. The current outlook for the rating is Stable.

THE FINANCIAL STATEMENTS

Balance Sheet

This statement reports the balances of the assets, liabilities, and net assets of PASSHE as of the end of the fiscal year. **Assets** include cash; investments reported at market value; the value of outstanding receivables due from students and other parties; and land, buildings, and equipment reported at cost, less accumulated depreciation. **Liabilities** include payments due to vendors and students; the balance of bonds payable; and liabilities such as workers' compensation (PASSHE is self-insured), compensated absences (the value of sick and annual leave earned by employees), and postretirement benefits (health and tuition benefits expected to be paid to certain current and future retirees). The difference between the assets and liabilities is reported as **net assets**.

Statement of Revenues, Expenses, and Changes in Net Assets

This statement reports the revenues earned and the expenses incurred during the fiscal year. The result is reported as an increase or decrease in net assets. In accordance with the Governmental Accounting Standards Board (GASB) requirements, PASSHE has classified revenues and expenses as either operating or nonoperating. GASB has determined that all public colleges' and universities' **state appropriations are nonoperating revenues**. In addition, GASB requires classification of gifts, investment income and expenses, unrealized gains and losses on investments, interest expense, and losses on disposals of assets as nonoperating; PASSHE classifies all of its remaining activities as operating.

Statement of Cash Flows
This statement's primary purpose is to provide relevant information about PASSHE's cash receipts and cash payments. It may be used to determine PASSHE's ability to generate future net cash flows and to meet its obligations as they come due and its need for external financing.

NET ASSETS

Net assets increased by $43.9 million in fiscal year 2009/10, as compared to a decrease of $58.5 million in fiscal year 2008/09. Following is a summary of the balance sheet at June 30, 2010 and 2009.

(in millions)	**June 30, 2010**	**June 30, 2009**
Capital assets, net	$1,464.8	$1,343.5
Other assets	1,295.2	1,177.0
Total assets	$2,760.0	$2,520.5
Workers' compensation liability	$16.5	$15.8
Compensated absences liability	104.0	99.6
Postretirement benefits liability	722.6	662.6
Bonds payable	825.4	739.7
Other liabilities	404.3	359.5
Total liabilities	2,072.8	1,877.2
Invested in capital assets, net of related debt	615.9	570.6
Restricted	67.9	68.0
Unrestricted	3.4	4.7
Total net assets	687.2	643.3
Total liabilities and net assets	$2,760.0	$2,520.5

- *Invested in capital assets, net of related debt* is the cost of land, buildings, improvements, equipment, furnishings, and library books, net of accumulated depreciation, less any associated debt (primarily bonds payable). This balance is not available for PASSHE's use in ongoing operations, since the underlying assets would have to be sold in order to use the balance to pay current or long-term obligations. The Commonwealth prohibits PASSHE from selling University land and buildings without prior approval.

- *Restricted* net assets represent the balances of funds received from the Commonwealth, donors, or grantors who have placed restrictions on the purpose for which the funds must be spent. *Nonexpendable* restricted net assets represent corpuses of endowments and similar arrangements in which only the associated investment income can be spent. *Expendable* restricted net assets are available for expenditure as long as any external purpose and time restrictions are met.

- *Unrestricted* net assets include funds that the Board has designated for specific purposes, auxiliary funds, and all other funds not appropriately classified as restricted or invested in capital assets. Unrestricted net assets reflect two unfunded liabilities:

  - The liability for **postretirement benefits** for employees who participate in the PASSHE plan increased by $60.0 million to $722.6 million for the year ended June 30, 2010. Because this liability is expected to be realized gradually over time, and because of its size, the Universities fund it only as it becomes due.

- The liability for **compensated absences** increased by $4.4 million to $104.0 million for the year ended June 30, 2010. Similar to the postretirement benefits liability, cash payouts to employees upon termination or retirement for annual and sick leave balances are expected to be realized gradually over time.

REVENUES AND EXPENSES

In addition to the changes to the appropriation and tuition revenue discussed in the Financial Highlights section of this analysis, following are the more significant revenue and expense items:

- **Financial aid** to students in the form of waivers and scholarships was $277.4 million, an increase of $60.5 million from the previous year. Waivers of tuition and fees are shown as a reduction of student tuition and fee revenues.

- **Investment income** (before investment expenses) for fiscal year 2009/10 was $28.3 million, a decrease of $7.6 million from the prior year. The decrease is due to decreasing interest rates. Interest rates decreased over the fiscal year from a high of 2.83% in July 2009 to a low of 1.60% in March 2010, or a 222-basis-point decrease from the prior fiscal year high. The 12-month average interest rate for fiscal year 2009/10 was 94 basis points lower than the average 12-month interest rate for fiscal year 2008/09.

- Universities spent $664.2 million on **instruction**, or 36.6% of total operating expenses, in fiscal year 2009/10. This represents an increase of $32.9 million, or 5.2%, over fiscal year 2008/09.

- **Salaries** and **benefits** totaled $1.25 billion. Salaries increased by $26.6 million, or 3.2%, while benefits increased by $27.9 million, or 7.8%, for an overall increase of $54.5 million over fiscal year 2008/09:

  - Employer hospitalization benefits assessed costs increased 16.9% over fiscal year 2008/09, for a total increase of $16.5 million. This follows an increase of 16.8% ($14.0 million) in fiscal year 2008/09 and a decrease of 3.7% ($3.1 million) in fiscal year 2007/08 over the prior fiscal years.

  - Employer annuitant health care assessed costs increased 4.9% over fiscal year 2008/09, for a total increase of $5.5 million. This follows consecutive increases of 7.9% ($8.2 million) and 4.5% ($4.7 million) in fiscal years 2008/09 and 2007/08, respectively, over the prior fiscal years. The increases are caused not only by the increase in health care costs, but also by the increase in the number of retired employees.

  - The total cost for all other employee benefits, such as social security, retirement, and tuition waivers, increased by a total of $5.9 million, or 4.0%, over fiscal year 2008/09, compared to an increase of $12.2 million in fiscal year 2008/09, or 9.1%, over fiscal year 2007/08.

- **Interest expense** on capital asset-related debt was $35.0 million, an increase of $3.2 million over fiscal year 2008/09.

Following is a summary of revenues and expenses for the years ending June 30, 2010 and 2009.

(in millions)	**June 30, 2010**	**June 30, 2009**
Operating revenues		
Tuition and fees, net	$667.4	$637.9
Grants and contracts	301.7	252.1
Auxiliary enterprises, net	294.2	280.0
Other	37.3	37.5
Total operating revenues	1,300.6	1,207.5
Other revenues		
State appropriations	532.8	508.9
Investment income, net	27.9	35.4
Unrealized gain (loss) on investment	15.9	(2.4)
Gifts, grants, and other	26.1	23.1
Total other revenues	602.7	565.0
Total revenues	$1,903.3	$1,772.5

(in millions)	**June 30, 2010**	**June 30, 2009**
Operating expenses		
Instruction	$664.2	$631.3
Research	7.1	7.3
Public service	36.4	40.7
Academic support	164.8	165.6
Student services	155.1	149.7
Institutional support	246.2	240.3
Operations and maintenance of plant	140.2	144.5
Depreciation	105.7	100.1
Student aid	76.9	60.1
Auxiliary enterprises	220.2	214.6
Total operating expenses	1,816.8	1,754.2
Other expenses		
Interest expense on capital asset-related debt	35.0	31.8
Loss on disposal of assets	7.3	45.0
Total other expenses	42.3	76.8
Total expenses	$1,859.1	$1,831.0

FUTURE ECONOMIC FACTORS

- The effects of the prolonged national recession continue to distress the **Commonwealth's budget**. In fiscal year 2010/11, PASSHE will receive $465.2 million in General Fund appropriations from the Commonwealth, equivalent to the General Fund appropriations received in fiscal year 2009/10—and equivalent to the appropriations received in fiscal year 2005/06. The Commonwealth also has appropriated to PASSHE $38.2 million of federal funds from the **ARRA** State Fiscal Stabilization Funds program in fiscal year 2010/11, $27.0 million less than the amount received in fiscal year 2009/10. Fiscal year 2010/11 is the last year for which ARRA funds are available.

- In 2010/11, for the second year in a row, the Realty Transfer Tax allocation from the **Key '93** funds to PASSHE has been eliminated by the Commonwealth. It is unclear whether or not this funding, a revenue stream for deferred maintenance projects previously consistent since 1993, will be restored in future years. These funds totaled $13.9 million in fiscal year 2008/09.

- PASSHE anticipates the **current economic downturn** will continue to have a negative effect on PASSHE's revenue through at least fiscal year 2011/12. Of particular concerns are the elimination of ARRA State Fiscal Stabilization Funds from the Commonwealth budget, state revenue receipts that continue to fall short of revenue estimates, and a looming crisis in the Pennsylvania State Employees Retirement System. PASSHE Universities are developing multiple financial plans that focus on sustainable actions to meet current and future funding constraints.

- In June 2009, PASSHE received notification from the **State Employees' Retirement System** (SERS) that the "extended period of low and relatively stable SERS employer contribution rates is coming to an end." Rates rose 30.5% in fiscal year 2010/11. They are expected to continue to rise in 2011/12, jump sharply in 2012/13, peak in 2013/14, and remain high for the foreseeable future. SERS is working with Commonwealth leadership to explore options for mitigating rate increases, but any realistic scenario reflects significantly higher rates for a sustained period. The Pennsylvania School Employees Retirement System (PSERS) is experiencing similar problems. Approximately 50% of PASSHE's employees receiving retirement benefits are enrolled in SERS or PSERS.

- PASSHE has eight **collective bargaining agreements** with seven employee unions. The compensation packages outlined in six of these agreements, representing 89% of PASSHE employees, expire June 30, 2011. At this time, future compensation requirements are unknown for these employees.

- The Board approved a 4.5% **increase in tuition** for the 2010/11 academic year. The $250 increase for full-time, resident undergraduate students sets the new rate at $5,804, the lowest among all four-year colleges and universities in Pennsylvania. Despite rising cost pressures and limited state funding, PASSHE has been able to hold overall tuition and fee increases to among the lowest of all public colleges and universities in the nation.

- PASSHE's **accountability and performance funding** systems, which have been in place since 2001, have been drivers for change to serve students and the Commonwealth better. PASSHE Universities have achieved improvements in retention; graduation rates; diversity of students, faculty, and administrators; program quality; faculty productivity; and the lowering of instructional costs. The current design, which incorporates both quantitative data and qualitative information, and monitors University performance over time in comparison to peer institutions and against System performance targets, has created a culture of accountability throughout PASSHE. As such, it has served as a national model for accountability and institutional improvement. Despite these successes, however, the accountability and performance funding programs are under review to assess how well they serve the strategic directions of the System. The review will seek improvements to ensure that the measures, reporting categories, measurement strategies, methodologies, and data elements all work together. PASSHE remains committed to funding its performance program at a level equivalent to 8.0% of the E&G appropriation.

- Of all PASSHE programs eligible for **accreditation**, 79% are now accredited, up from about 53% in 2004. Students enrolling at PASSHE Universities as first-time freshmen are reporting higher average scores on the Scholastic Assessment Test (SAT) as well as higher high school grade point averages.

- In 2009/10, PASSHE became a founding member and board member of the **Keystone Initiative for Network Based Education and Research (KINBER)**, a nonprofit corporation of Pennsylvania colleges and universities, research and health care organizations, and economic development entities, created to establish and operate a high-speed network in Pennsylvania for education and research purposes. In February 2010, the Obama Administration awarded KINBER $99.6 million in federal stimulus (ARRA) funding in response to KINBER's application for the construction and management of a robust, statewide, broadband network. When completed, the fiber-optic cable network will extend over 1,600 miles through 39 Pennsylvania counties. The network will bring new broadband capacity necessary for distance education, economic development, and telemedicine. The federal grant is being supplemented with an additional $29 million in private investment to establish the Pennsylvania Research and Education Network (PennREN). PennREN is expected to start construction in fall 2010 and be completed early in 2013. This extraordinary collaboration is expected to benefit greatly PASSHE's students, faculty, and University communities with new economic, academic, telemedicine, and research opportunities.

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Pennsylvania State System of Higher Education

Balance Sheet

(dollars in thousands)

Assets

	June 30, 2010	June 30, 2009
Current Assets		
Cash and cash equivalents	$ 8,912	$ 12,135
Short-term investments	393,210	306,003
Accounts receivable, net of allowance for doubtful accounts of $19,121 in 2010 and $20,145 in 2009	91,005	74,077
Inventories	3,833	3,996
Prepaid expenses	8,452	6,927
Current portion of loans receivable	5,483	5,938
Due from component units	18,001	15,535
Other current assets	2,767	3,400
Total Current Assets	531,663	428,011
Noncurrent Assets		
Restricted cash and cash equivalents	3,091	849
Endowment investments	23,601	21,311
Other long-term investments	697,462	685,955
Loans receivable, net of allowance for doubtful accounts of $5,049 in 2010 and $5,367 in 2009	32,921	33,650
Capital Assets:		
Land	24,770	22,807
Buildings, including improvements	1,553,171	1,416,840
Improvements other than buildings	211,245	193,074
Equipment and furnishings	366,450	347,486
Library books	83,848	83,529
Construction in progress	159,881	127,016
	2,399,365	2,190,752
Less accumulated depreciation	(934,565)	(847,286)
Capital assets, net	1,464,800	1,343,466
Other noncurrent assets	6,419	7,216
Total Noncurrent Assets	2,228,294	2,092,447
Total Assets	$ 2,759,957	$ 2,520,458

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Balance Sheet

(dollars in thousands)

Liabilities and Net Assets

	June 30, 2010	June 30, 2009
Current Liabilities		
Accounts payable and accrued expenses	$ 197,088	$ 164,923
Deferred revenue	51,441	50,675
Deposits	9,854	22,397
Current portion of workers' compensation liability	4,743	4,503
Current portion of compensated absences liability	10,201	10,541
Current portion of postretirement benefits liability	48,545	48,799
Current portion of capitalized lease obligations	3,138	2,908
Current portion of bonds payable	39,975	38,255
Other current liabilities	40,010	20,769
Total Current Liabilities	404,995	363,770
Noncurrent Liabilities		
Deferred revenue	2,946	4,284
Deposits	252	1,945
Workers' compensation liability	11,741	11,321
Compensated absences liability	93,841	89,057
Postretirement benefits liability	674,029	613,834
Capitalized lease obligations	44,366	40,601
Bonds payable	785,375	701,425
Other noncurrent liabilities	55,186	50,997
Total Noncurrent Liabilities	1,667,736	1,513,464
Total Liabilities	2,072,731	1,877,234
Net Assets		
Invested in capital assets, net of related debt	615,939	570,569
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	21,369	19,488
Other	1,530	1,441
Expendable:		
Scholarships and fellowships	10,992	10,072
Research	1,691	1,723
Student loans	393	490
Capital projects	26,642	27,565
Other	5,315	7,131
Unrestricted	3,355	4,745
Total Net Assets	687,226	643,224
Total Liabilities and Net Assets	$ 2,759,957	$ 2,520,458

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Statement of Revenues, Expenses, and Changes in Net Assets
For the Years Ended June 30, 2010 and 2009
(dollars in thousands)

	2010		2009	
Operating Revenues				
Tuition and fees	$ 866,663		$ 793,443	
Less scholarship discounts and allowances	(199,297)		(155,509)	
Net tuition and fees		$ 667,366		$ 637,934
Governmental grants and contracts:				
Federal		181,809		133,789
State		107,811		106,435
Local		3,310		3,464
Nongovernmental grants and contracts		8,723		8,389
Sales and services		20,195		21,545
Auxiliary enterprises, net of discounts of $762 in 2010 and $877 in 2009		294,239		280,002
Other revenues		17,071		15,855
Total Operating Revenues		1,300,524		1,207,413
Operating Expenses				
Instruction		664,179		631,270
Research		7,055		7,296
Public service		36,354		40,678
Academic support		164,777		165,648
Student services		155,133		149,698
Institutional support		246,209		240,351
Operations and maintenance of plant		140,245		144,482
Depreciation		105,733		100,067
Student aid		76,944		60,136
Auxiliary enterprises		220,244		214,554
Total Operating Expenses		1,816,873		1,754,180
Operating Loss		(516,349)		(546,767)
Nonoperating Revenues (Expenses)				
State appropriations, general and restricted		465,197		497,168
ARRA State Fiscal Stabilization Funds		65,226		-
Investment income, net of related investment expense of $433 in 2010 and $433 in 2009		27,883		35,423
Unrealized gain (loss) on investments		15,917		(2,376)
Gifts for other than capital purposes		11,818		10,621
Interest expense on capital asset-related debt		(34,977)		(31,769)
Loss on disposal of assets		(7,312)		(44,960)
Other nonoperating revenue		1,509		1,445
Net Nonoperating Revenues		545,261		465,552
Income (loss) before other revenues		28,912		(81,215)
State appropriations, capital		2,358		11,726
Capital gifts and grants		12,732		10,955
Increase (Decrease) in Net Assets		44,002		(58,534)
Net assets—beginning of year		643,224		701,758
Net assets—end of year		$ 687,226		$ 643,224

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Statement of Cash Flows
For the Years Ended June 30, 2010 and 2009

(dollars in thousands)

	2010	2009
Cash Flows from Operating Activities		
Tuition and fees	$ 660,654	$ 639,473
Grants and contracts	290,128	273,152
Payments to suppliers for goods and services	(374,001)	(426,846)
Payments to employees	(1,158,903)	(1,138,598)
Loans issued to students	(4,427)	(6,615)
Loans collected from students	5,522	5,601
Student aid	(77,295)	(60,500)
Auxiliary enterprise charges	292,457	283,016
Sales and services	19,853	27,423
Other receipts	22,788	17,818
Net cash used by operating activities	(323,224)	(386,076)
Cash Flows from Noncapital Financing Activities		
State appropriations, including Federal ARRA	530,423	497,168
Gifts for other than capital purposes	11,618	10,410
PLUS, Stafford, and other loans receipts (non-Perkins)	711,558	682,135
PLUS, Stafford, and other loans disbursements (non-Perkins)	(711,672)	(681,588)
Agency transactions, net	(1,640)	4,092
Other	1,509	1,445
Net cash provided by noncapital financing activities	541,796	513,662
Cash Flows from Capital Financing Activities		
Proceeds from capital debt and leases	176,536	176,994
Capital appropriations	1,784	11,551
Capital grants and gifts received	12,000	10,625
Proceeds from sales of capital assets	35	224
Purchases of capital assets	(227,339)	(216,022)
Principal paid on capital debt and leases	(88,875)	(76,888)
Interest paid on capital debt and leases	(37,033)	(29,917)
Net cash used by capital financing activities	(162,892)	(123,433)
Cash Flows from Investing Activities		
Proceeds from sales and maturities of investments	24,756,520	22,723,113
Interest on investments	28,484	35,618
Purchase of investments	(24,841,665)	(22,771,763)
Net cash used by investing activities	(56,661)	(13,032)
Net Decrease in Cash and Cash Equivalents	(981)	(8,879)
Cash and cash equivalents—beginning of year	12,984	21,863
Cash and cash equivalents—end of year	$ 12,003	$ 12,984

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Statement of Cash Flows
For the Years Ended June 30, 2010 and 2009

(dollars in thousands)

	2010	2009
Reconciliation of Operating Loss to Net Cash Used by Operating Activities		
Operating loss	$ (516,349)	$ (546,767)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	105,733	100,067
Expenses paid by Commonwealth or donor	655	389
Changes in assets and liabilities:		
Receivables, net	(16,035)	23,195
Inventories	163	586
Other assets	(4,084)	(3,032)
Accounts payable	36,191	(13,873)
Deferred revenue	(572)	3,715
Student deposits	(1,095)	576
Compensated absences	4,444	4,061
Loans to students and employees	1,095	(1,013)
Other liabilities	66,630	46,020
Net cash used by operating activities	$ (323,224)	$ (386,076)
Noncash Transactions		
Equipment	$ 7,970	$ 3,500
Capital lease	$ 6,379	$ 557

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Component Units Statement of Financial Position

(dollars in thousands)

	June 30, 2010	June 30, 2009
Assets		
Cash and cash equivalents	$ 101,886	$ 105,550
Accounts receivable	6,065	7,565
Contributions/pledges receivable	20,352	24,810
Due from Universities	40,585	41,535
Inventories	9,636	10,227
Short-term investments	75,712	26,299
Investments	227,596	203,332
Capital assets:		
Land	18,662	15,543
Buildings	747,543	555,807
Building improvements	13,867	8,396
Improvements other than buildings	7,519	6,601
Equipment and furnishings	53,727	46,265
Construction in progress	40,265	167,352
	881,583	799,964
Less accumulated depreciation	(103,021)	(79,087)
Capital assets, net	778,562	720,877
Other assets	79,484	89,552
Total Assets	$ 1,339,878	$ 1,229,747
Liabilities		
Accounts payable and accrued expenses	$ 25,605	$ 30,673
Annuity liabilities	8,334	8,190
Due to Universities	27,296	22,193
Deposits payable	11,231	9,531
Capitalized leases	18,784	20,159
Bonds payable	676,627	683,113
Notes payable	254,476	163,467
Other liabilities	77,280	57,074
Total Liabilities	1,099,633	994,400
Net Assets		
Unrestricted	17,859	31,406
Temporarily restricted	60,930	58,890
Permanently restricted	161,456	145,051
Total Net Assets	240,245	235,347
Total Liabilities and Net Assets	$ 1,339,878	$ 1,229,747

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Component Units Statement of Activities
For the Years Ended June 30, 2010 and 2009

(dollars in thousands)

	2010	2009
Revenues and Gains		
Contributions	$ 39,644	$ 39,767
Sales and services	52,809	53,866
Student fees	27,946	24,217
Grants and contracts	13,507	9,395
Rental income	89,871	63,819
Investment income (loss)	12,184	(1,577)
Unrealized gain (loss) on investments	554	(44,795)
Other revenues and gains	3,009	963
Total Revenues and Gains	239,524	145,655
Expenses and Losses		
Program services:		
Scholarships and grants	10,828	12,467
Student activities and programs	25,365	22,900
University stores	36,626	36,836
Housing	91,927	62,032
Other University support	17,541	15,881
Other programs	19,239	20,750
Management and general	25,111	25,020
Fundraising	7,989	8,277
Total Expenses and Losses	234,626	204,163
Change in Net Assets	4,898	(58,508)
Net assets—beginning of year	235,347	293,855
Net assets—end of year	$ 240,245	$ 235,347

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

Years ended June 30, 2010 and 2009

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Pennsylvania State System of Higher Education (PASSHE) is a body corporate and politic, created by the State System of Higher Education Act of November 12, 1982, P.L. 660, No. 188, as amended (Act 188). PASSHE is a component unit of the Commonwealth of Pennsylvania (Commonwealth) and is governed by a Board of Governors (Board), as provided for in Act 188. PASSHE comprises the 14 Universities of the Pennsylvania State System of Higher Education and the Office of the Chancellor.

Reporting Entity

PASSHE functions as a Business Type Activity, as defined by the Governmental Accounting Standards Board (GASB).

Certain affiliated organizations are included in PASSHE's financial statements as discretely presented component units. Some of the organizations, such as University student associations, are included because the Board has oversight responsibility for the organizations. The criteria used in determining the organizations for which PASSHE has oversight responsibility include financial interdependency, the ability to select members of the governing body, the ability to designate management, the ability to influence operations significantly, and accountability for fiscal matters. Other affiliated organizations for which the Board does not have oversight responsibility, such as University foundations and alumni associations, are included when the economic resources received or held by the organization are entirely or almost entirely for the direct benefit of PASSHE, PASSHE historically has received a majority of these economic resources, and the activity of the organization is significant to PASSHE Universities. Neither PASSHE nor its Universities control the timing or amount of receipts from these organizations.

PASSHE does not consider any of its component units to be major, and has aggregated all component unit information into a separate set of financial statements. Information on individual component units can be obtained by contacting the respective Universities.

Transactions between the Universities and the Office of the Chancellor have been eliminated in the accompanying financial statements.

Measurement Focus, Basis of Accounting, and Basis of Presentation

The accompanying financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America, as prescribed by GASB. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met. PASSHE applies the Financial Accounting Standards Board pronouncements issued before November 30, 1989, only, except for those that conflict with GASB pronouncements.

Operating Revenues

PASSHE records tuition; all academic, instructional, and other student fees; student financial aid; auxiliary activity; corporate partnerships; and revenue from cogeneration sales as operating revenue. In addition, governmental and private grants and contracts in which the grantor receives equal value for the funds given to the University are recorded as operating revenue. All expenses, with the exception of interest expense, loss on investments, loss on the disposal of assets, and extraordinary expenses, are recorded as operating expenses. Appropriations, gifts, investment income, capital grants, gains on investments, gains on the disposal of assets, parking and library fines, and governmental and private research grants and contracts in which the grantor does not receive equal value for the funds given to the University are reported as nonoperating revenue.

Net Assets
PASSHE maintains the following net asset classifications:

Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, repair, or improvement of those assets.

Restricted—nonexpendable: Net assets subject to externally imposed conditions requiring that they be maintained by PASSHE in perpetuity.

Restricted—expendable: Net assets whose use is subject to externally imposed conditions that can be fulfilled by the actions of PASSHE or by the passage of time.

Unrestricted: All other categories of net assets. Unrestricted net assets may be designated for specific purposes by the Board.

When both restricted and unrestricted funds are available for expenditure, the decision as to which funds are used first is left to the discretion of the Universities.

Cash Equivalents and Investments
PASSHE considers all demand and time deposits and money market funds as cash equivalents. Investments purchased are stated at fair value. Investments received as gifts are recorded at their fair value or appraised value as of the date of the gift.

Accounts Receivable
Accounts receivable consist of tuition and fees charged to current and former students and amounts due from federal and state governments in connection with reimbursements of allowable expenditures made pursuant to grants, contracts, and other miscellaneous sources.

Accounts receivable are reported at net realizable value. Accounts are written off when they are determined to be uncollectible based upon management's assessment of individual accounts. The allowance for doubtful accounts is estimated based upon the Universities' historical losses and periodic review of individual accounts.

Inventories
Inventories are stated at the lower of cost or market, with cost being determined principally on the weighted average method.

Capital Assets
Land and buildings at the 14 University campuses acquired or constructed prior to its creation on July 1, 1983, are owned by the Commonwealth and made available to the Universities of PASSHE. Since PASSHE neither owns such assets nor is responsible to service associated bond indebtedness, no value is ascribed thereto in the accompanying financial statements. Likewise, no value is ascribed to the portion of any land or buildings acquired or constructed utilizing capital funds appropriated by the Commonwealth after June 30, 1983, and made available to the Universities.

All assets with a purchase cost, or fair value if acquired by gift, in excess of $5,000, with an estimated useful life of two years or greater, are capitalized. Buildings, portions of buildings, and capital improvements acquired or constructed by the Universities after June 30, 1983, through the expenditure of University funds or the incurring of debt are stated at cost less accumulated depreciation.

Equipment and furnishings are stated at cost less accumulated depreciation. All library books are capitalized and depreciated. PASSHE provides for depreciation on the straight-line method over the estimated useful lives of the related assets. Buildings and improvements are depreciated over useful lives ranging from 10 to 40 years. Equipment and furnishings are depreciated over useful lives ranging from 3 to 10 years. Library books are depreciated over 10 years. Normal repair and maintenance expenditures are not capitalized because they neither add to the value of the property nor materially prolong its useful life.

Impairment of Capital Assets
Management reviews capital assets for impairment whenever events or changes in circumstances indicate that the service utility of an asset has declined significantly and unexpectedly. Any write-downs due to impairment are charged to operations at the time impairment is identified. No write-down of capital assets was required for the year ended June 30, 2010. In the year ending June 30, 2009, capitalized assets totaling $40.9 million were recorded as a loss on disposal of assets as a result of the termination of the implementation of the Student Life Cycle Management module of the Shared Administrative System.

Compensated Absences

Employees' right to receive annual leave and sick leave payments upon termination or retirement for services already rendered is recorded as a liability.

Pension Plans

Employees of PASSHE enroll in one of three available retirement plans immediately upon employment. PASSHE recognizes annual pension expenditures equal to its contractually required contributions to the plan.

Student Fees

Student tuition and dining, residence, and other fees are presented net of scholarships or other discounts applied to student accounts. Certain other scholarship or discount amounts are paid directly to or refunded to the students and generally are reflected as expenses.

Income Taxes

PASSHE and its member Universities are tax-exempt; accordingly, no provision for income taxes has been made in the accompanying financial statements.

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 of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New Accounting Standards

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets.* Statement No. 51 establishes accounting and financial reporting requirements for intangible assets, specifically with regard to whether and when intangible assets should be considered capital assets for financial reporting purposes. Statement No. 51 is effective for the fiscal year ending June 30, 2010. In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.* Statement No. 53 provides a comprehensive framework for the measurement, recognition, and disclosure of derivative instrument transactions. Statement No. 53 is effective for the fiscal year ending June 30, 2010. In February 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions.* Statement No. 54 establishes fund balance classifications for governmental funds. PASSHE is required to adopt Statement No. 54 for the fiscal year ending June 30, 2011. In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans.* Statement No. 57 amends Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* and Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. PASSHE is required to adopt Statement No. 57 for the fiscal year ending June 30, 2012. In December 2009, GASB issued Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies.* Statement No. 58 provides accounting and financial reporting guidance for governments that have petitioned for protection from creditors by filing bankruptcy under Chapter 9 of the United States Bankruptcy Code. PASSHE is required to adopt Statement No. 58 for the fiscal year ending June 30, 2011. In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus.* Statement No. 59 updates existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools. PASSHE is required to adopt Statement No. 59 for the fiscal year ending June 30, 2011. PASSHE has determined that Statements No. 51, 53, 54, 57, 58, and 59 have no effect on its balance sheet or statement of revenues, expenses, and changes in net assets.

(2) Deposits and Investments

PASSHE invests its funds in accordance with the Board's Investment Policy, which authorizes PASSHE to invest in repurchase agreements, commercial paper, obligations of the United States Treasury, agencies and sponsored entities, certificates of deposit, municipal bonds, mortgage-backed securities, asset-backed securities, banker's acceptances, and corporate bonds. Restricted nonexpendable funds and amounts designated by the Board or University trustees may be invested in the investments described above, as well as in corporate equities and approved pooled common funds. For purposes of convenience and expedience, Universities use local financial institutions for activities such as cash deposits. In addition, Universities may accept gifts of investments from donors as long as risk is limited to the investment itself. Restricted gifts of investments fall outside the scope of the investment policy.

In keeping with its legal status as a system of public universities, PASSHE recognizes a fiduciary responsibility to invest all funds prudently in accordance with ethical and prevailing legal standards. In addition, PASSHE recognizes that the funds in its custody can be classified according to purpose, time frame for use, source, and other similar classifications. Differential investment guidelines and objectives are required to manage various funds classifications appropriately and optimally.

Regardless of funds classifications, certain general tenets apply. Investments in all classifications seek to minimize exogenous risks while maintaining or expanding purchasing power. Adequate liquidity is maintained so assets are held to maturity. In all classifications, high quality investments are preferred. Reasonable portfolio diversification is pursued to ensure that no single security or investment or class of securities or investments will have a disproportionate or significant impact on the total portfolio. Investments are made in U.S.-based corporations. Investment performance in all classifications is monitored on a frequent and regular basis to ensure that objectives are attained and guidelines are followed. A portfolio duration target of 1.8 years is maintained with an upper limit of 2.2 years.

Safety of principal and liquidity are the top priorities for the investment of PASSHE's operating funds. Within those guidelines, income optimization is pursued. Speculative investment activity is not allowed; this includes investing in asset classes such as commodities, futures, short-sales, equities, real or personal property, options, venture capital investments, private placements, letter stocks, and unlisted securities. Collateralized mortgage obligations (CMOs) are sometimes based on cash flows from interest-only (IO) payments or principal-only (PO) payments and are sensitive to prepayment risks. The CMOs in PASSHE's portfolio do not have IO or PO structures; however, they are subject to extension or contraction risk based on movements in interest rates. PASSHE's operating funds are invested and reinvested in the following types of instruments with qualifications as provided.

Investment Categories	**Limit (% of Market Value)**	**Single Issuer (Maximum)**	**Rating Limit (Moody's)**
Government securities/repurchase agreements	Greater than 20%	5% repurchase	N/A
Commercial paper/certificates of deposit/banker's acceptances	Less than 30%	5% of each type	P-1
Municipal bonds	Less than 20%	5%	Aa or higher
Corporate bonds	Less than 20%	N/A	Aa or higher
Collateralized mortgage obligations (CMOs)	Less than 20%	N/A	Aaa
Asset-backed securities	Less than 20%	N/A	Aaa
System notes	Less than 20%	5%	N/A

On June 30, 2010 and 2009, the carrying amount of PASSHE's demand and time deposits and certificates of deposit for all funds was $12,026,000 and $13,008,000, respectively, compared to bank balances of $14,340,000 and $12,930,000, respectively. The difference is caused primarily by items in transit. Of the bank balances, $3,154,000 and $2,926,000, respectively, were covered by federal government depository insurance or collateralized by a pledge of United States Treasury obligations held by Federal Reserve banks in the name of the banking institutions; $648,000 and $749,000, respectively, were uninsured and uncollateralized; and $10,538,000 and $9,255,000, respectively, were uninsured and uncollateralized, but covered under the collateralization provisions of the Commonwealth of Pennsylvania Act 72 of 1971, as amended. Act 72 allows banking institutions to satisfy the collateralization requirements by pooling eligible investments to cover total public funds on deposit in excess of federal insurance. Such pooled collateral is pledged with the financial institutions' trust departments. The carrying values (fair values) of deposits and investments for PASSHE's pooled funds in M&T Bank on June 30, 2010 and 2009, follow.

PASSHE Pooled Deposits and Investments
June 30, 2010
(in thousands)

	Moody's Rating (if applicable)	**Modified Duration** (if applicable)	**Fair Value**
Deposits			
Money market funds			$2,075
Total deposits			2,075
Investments			
Repurchase agreements			19,299
Commercial paper	P1	0.07	252,832
U.S. government and agency obligations	Aaa	4.55	441,646
Asset-backed securities	Aaa	0.47	85,121
Collateralized mortgage obligations (CMOs)	Aaa	3.33	156,676
Corporate bonds and notes	Aaa	1.06	28,047
	Aa1	2.32	15,837
	Aa2	2.35	45,417
	Aa3	1.67	10,171
	A1	1.42	18,168
	A2	0.94	6,994
	A3	2.78	2,447
	Baa1	2.01	5,052
Total investments			1,087,707
Total deposits and investments			$1,089,782

PASSHE Pooled Deposits and Investments
June 30, 2009
(in thousands)

	Moody's Rating (if applicable)	Modified Duration (if applicable)	Fair Value
Deposits			
Demand and time deposits			$100
Money market funds			227
Total deposits			327
Investments			
Commercial paper	P1	0.02	96,435
U.S. government and agency obligations	Aaa	4.10	542,949
Asset-backed securities	Aaa	0.58	22,960
	Not rated	0.23	877
Collateralized mortgage obligations (CMOs)	Aaa	4.47	142,241
Corporate bonds and notes	Aaa	2.02	28,163
	Aa1	3.10	13,792
	Aa2	1.74	82,871
	Aa3	1.28	12,271
	A1	2.32	18,312
	A2	1.02	20,946
	A3	3.59	2,428
	Baa1	2.89	5,076
Total investments			989,321
Total deposits and investments			$989,648

Of the investments noted above at June 30, 2010 and 2009, $38,645,000 and $30,423,000, respectively, were held by a trustee to be used for projects funded under the Pennsylvania Higher Educational Facilities Authority/State System of Higher Education bond issues (note 9). Investments are made subject to the restrictions of the bond indenture and may be liquidated only for the payment of costs associated with the projects described in the bond indenture.

The carrying values (fair values) of deposits and investments for local University deposits and investments on June 30, 2010 and 2009, follow.

University Local Deposits and Investments
June 30, 2010
(in thousands)

	Moody's Rating (if applicable)	Modified Duration (if applicable)	Fair Value
Deposits			
Demand and time deposits			$9,928
Certificates of deposit			23
Total deposits			9,951
Investments			
U.S. government and agency obligations		1.31	537
Fixed income mutual funds		3.82	3,837
Equity/balanced mutual funds			20,750
Common stock			1,419
Total investments			26,543
Total deposits and investments			$36,494

University Local Deposits and Investments
June 30, 2009
(in thousands)

	Moody's Rating (if applicable)	Modified Duration (if applicable)	Fair Value
Deposits			
Demand and time deposits			$12,657
Certificates of deposit			24
Total deposits			12,681
Investments			
U.S. government and agency obligations		1.64	769
Fixed income mutual funds		3.98	3,564
Equity/balanced mutual funds			17,846
Common stock			1,745
Total investments			23,924
Total deposits and investments			$36,605

Of the local investments noted above, the exposure to foreign currency risk is as follows *(in thousands)*.

Investment	Currency	Fair Value	
		June 30, 2010	June 30, 2009
Deposit	British Pound	$13	$82
Deposit	Euro	4	24
Total		$17	$106

The Universities are beneficiaries of trust funds held by others with an approximate fair value of $3,090,000 and $3,328,000 on June 30, 2010 and 2009, respectively. Since the Universities have neither possession nor control of these trusts, the principal is not included in the accompanying balance sheet.

(3) Leases

Total rent expense for PASSHE operating leases amounted to $8,555,000 and $9,796,000 for the years ended June 30, 2010 and 2009, respectively.

Capital assets on June 30, 2010 and 2009, included $59,999,000 and $55,125,000, respectively, acquired through leases that have been capitalized.

Future minimum payments, by year and in the aggregate, under capital and noncancelable operating leases, with initial or remaining terms of one year or more, are as follows .

(in thousands)	Operating Leases	Capital Leases
2011	$5,260	$5,150
2012	2,789	4,925
2013	1,802	4,637
2014	1,308	4,545
2015	796	4,372
Thereafter	876	42,057
Total minimum lease payments	$12,831	65,686
Amount representing interest on capital leases		18,182
Present value of net minimum capital lease payments		$47,504

(4) Pension Benefits

The Public School Employees' Retirement System (PSERS) and the Commonwealth of Pennsylvania State Employees' Retirement System (SERS) are governmental cost-sharing multiple-employer defined benefits plans. The Alternative Retirement Plan (ARP) is a defined contribution plan administered by PASSHE.

PSERS provides retirement and disability benefits, legislative-mandated ad hoc cost-of-living adjustments, and health care insurance premium assistance to qualifying annuitants. The Public School Employees' Retirement Code (Act No. 96 of October 2, 1975, as amended) (24 Pa.C.S. §§8101-8535) is the authority by which PSERS benefits provisions are established and may be amended. The contribution policy for PSERS is established in the Public School Employees' Retirement Code and requires contributions by active members, the employer (PASSHE), and the Commonwealth of Pennsylvania. Active members contribute at a rate of between 5.25% and 7.50% of their qualifying compensation, depending upon when the active member was hired and what benefits class was selected. The contribution rate for PASSHE is an actuarially determined rate. The rate was 2.39% of annual covered payroll at June 30, 2010. PASSHE's contributions to PSERS for the years ended June 30, 2010, 2009, and 2008, were $948,000, $852,000, and $1,153,000, respectively, equal to the required contractual contribution. PSERS issues a comprehensive annual financial report that includes financial statements and required supplementary information for the plan. A copy of the report may be obtained by writing to Public School Employees' Retirement System, P.O. Box 125, Harrisburg, PA 17108-0125.

SERS provides retirement, death, and disability benefits, and legislative-mandated ad hoc cost-of-living adjustments. Article II of the Commonwealth of Pennsylvania's Constitution assigns the authority to establish and amend the benefits provisions of the plan to the General Assembly. The contribution policy for SERS, as established by the State Employees' Retirement Code, requires contributions by active members and the employer (PASSHE). The contribution rate for both active members and PASSHE depends upon when the active member was hired and what benefits class is selected. Active members contribute at a rate of either 5.0% or 6.25% of their qualifying compensation. PASSHE contributed at an actuarially determined rate of either 2.52% or 3.15% of an active member's annual covered payroll at June 30, 2010. PASSHE's contributions to SERS for the years ended June 30, 2010, 2009, and 2008, were $10,182,000, $9,770,000, and $9,508,000, respectively, equal to the required contractual contribution. SERS issues a publicly available annual financial report that includes financial statements and required supplementary information for the plan. A copy of the report may be obtained by writing to Commonwealth of Pennsylvania, State Employees' Retirement System, P.O. Box 1147, Harrisburg, PA 17108.

Because the ARP is a defined contribution plan, benefits depend upon amounts contributed to the plan plus investment earnings. Act 188 empowers the Board to establish and amend benefits provisions. The State Employees' Retirement Code establishes the employer contribution rate for the ARP, while the Board establishes the employee contribution rates. Active members contribute at a rate of 5% of their qualifying compensation. PASSHE's contribution rate on June 30, 2010 and 2009, was 9.29% of qualifying compensation. The contributions to the ARP for the years ended June 30, 2010 and 2009, were $41,295,000 and $39,634,000, respectively, from PASSHE, and $21,923,000 and $21,899,000, respectively, from active members.

(5) Postretirement Benefits

PASSHE employees who retire after meeting specified service and age requirements become eligible for participation in one of two defined health care benefits plans, referred to here as the *System Plan* and the *Retired Employees Health Program*. These plans include hospital, medical/surgical, and major medical coverage, and provide a Medicare supplement for individuals over age 65.

System Plan

Plan Description

Employee members of the Association of Pennsylvania State College and University Faculties, the State College and University Professional Association, Security Police and Fire Professionals of America, Pennsylvania Nurses Association, and nonrepresented employees participate in a single-employer defined benefits health care plan administered by PASSHE (System Plan). The System Plan provides eligible retirees and their eligible dependents with health care benefits, as well as tuition waivers at any of PASSHE's Universities. Act 188 empowers the Board to establish and amend benefits provisions. The System Plan is unfunded, and no financial report is prepared.

Funding Policy

The contribution requirements of plan members and PASSHE are established and may be amended by the Board. The System Plan is funded on a pay-as-you-go basis, i.e., premiums are paid to an insurance company and various health maintenance organizations to fund the health care benefits provided to current retirees. Tuition waivers are provided by the retiree's sponsoring University as they are granted. PASSHE paid premiums of $31,830,000 and $43,847,000 for the fiscal years ending June 30, 2010 and 2009, respectively. Plan members receiving benefits who retired prior to July 1, 2005, are not required to make contributions. Plan members receiving benefits who retire after July 1, 2005, contribute at various rates, depending upon when they retire, whether they are eligible for Medicare, the contribution rate in effect on the day of their retirement, the contribution rate for active employees, and applicable collective bargaining agreements. As of June 30, 2010, the maximum rate being contributed by plan members was 10% of the premium currently paid by active employees. Total contributions made by plan members were $2,080,000 and $1,951,000, or approximately 6.1% and 4.3% of the total premiums, for the fiscal years ending June 30, 2010 and 2009, respectively.

Annual OPEB Cost and Net OPEB Obligation

PASSHE's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The following shows the components of PASSHE's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in PASSHE's net OPEB obligation.

(in thousands)	
Annual required contribution	$92,989
Interest on net OPEB obligation	31,475
Adjustment to annual required contribution	(32,693)
Annual OPEB cost (expense)	91,771
Contributions made	(31,830)
Increase in net OPEB obligation	59,941
Net OPEB obligation at July 1, 2009	662,633
Net OPEB obligation at June 30, 2010	$722,574

PASSHE's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for June 30, 2010, and the two preceding years were as follows *(in thousands)*.

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
June 30, 2010	$91,771	34.7%	$722,574
June 30, 2009	$85,450	51.3%	$662,633
June 30, 2008	$83,228	28.0%	$621,030

Funded Status and Funding Progress

The funded status of the plan as of July 1, 2009, the most recent actuarial valuation date, was as follows:

(in thousands)	
Actuarial accrued liability (AAL)	$1,127,437
Actuarial value of plan assets	0
Unfunded actuarial accrued liability (UAAL)	$1,127,437
Funded ratio (actuarial value of plan assets/AAL)	0%
Covered payroll (active plan members)	$525,684
UAAL as a percentage of covered payroll	214%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the health care cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefits costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the July 1, 2009, actuarial valuation, the projected unit credit method was used. The actuarial assumptions included a 4.75% investment rate of return, which is the expected rate to be earned on PASSHE's operating portfolio, and an annual health care cost trend rate of 8.5% initially, reduced by decrements to an ultimate rate of 4.8% by 2020. The UAAL is being amortized as a level percentage of payroll on a closed basis. The remaining amortization period at July 1, 2009, was 26 years.

Retired Employees Health Program

Plan Description

Employee members of the American Federation of State, County and Municipal Employees; Pennsylvania Doctors Alliance; and Pennsylvania Social Services Union participate in the Retired Employees Health Program (REHP), which is sponsored by the Commonwealth and administered by the Pennsylvania Employee Benefits Trust Fund (PEBTF). The REHP provides eligible retirees and their eligible dependents with health care benefits. Benefits provisions are established and may be amended under pertinent statutory authority. The REHP neither issues a stand-alone financial report nor is it included in the report of a public employee retirement system or other entity.

Funding Policy

The contribution requirements of plan members covered under collective bargaining agreements are established by the collective bargaining agreements. The contribution requirements of nonrepresented plan members and contributing entities are established and may be amended by the Commonwealth's Office of Administration and the Governor's Budget Office. Plan members who enrolled prior to July 1, 2004, are not required to make contributions. Plan members who enrolled after July 1, 2004, contribute a percentage of their final salary, the rate of which varies based on the plan member's enrollment date. Agency member (employer) contributions are established primarily on a pay-as-you-go basis. In 2009/10, PASSHE contributed $248.68 for each current active employee per biweekly pay period. PASSHE made contributions of $25,318,000, $26,131,000, and $24,858,000 for the fiscal years ending June 30, 2010, 2009, and 2008, respectively, which equaled the required contributions for the year. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

(6) Workers' Compensation

PASSHE is self-insured for workers' compensation losses. For claims occurring prior to July 1, 1995, PASSHE Universities are responsible for claims less than $100,000; for claims occurring on or after July 1, 1995, PASSHE Universities are responsible for claims less than $200,000. Claims in excess of the self-insurance limits are funded through the Workers' Compensation Collective Reserve Fund (Reserve Fund), to which all PASSHE Universities contribute an amount determined by an independent actuarial study. Based on updated actuarial studies, the Universities contributed $1,621,000 and $784,000 to the Reserve Fund during the years ended June 30, 2010 and 2009, respectively.

For the years ended June 30, 2010 and 2009, the aggregate liability for claims under the self-insurance limit was $9,270,000 and $9,545,000, respectively. The Reserve Fund assets of $7,214,000 and $6,279,000 are equal to the liability for claims in excess of the self-insurance limits for the years ended June 30, 2010 and 2009, respectively. Changes in the workers' compensation claims liability amount in fiscal years 2010 and 2009 follow.

(in thousands)

Year	Beginning of Fiscal Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	Balance at Fiscal Year-End
2009	$14,429	$5,810	$4,415	$15,824
2010	$15,824	$6,048	$5,388	$16,484

(7) Compensated Absences

Compensated absences activity is as follows.

(in thousands)

Year	Beginning Balance	Current Changes in Estimates	Less Payouts	Ending Balance
2009	$95,537	$10,231	$6,170	$99,598
2010	$99,598	$11,733	$7,289	$104,042

(8) Termination Benefits

In March 2010, the Board approved a Voluntary Retirement Incentive Program for both union and nonrepresented employees meeting certain age and service requirements. Eligible employees who by May 28, 2010, indicated their intent to retire between June 18, 2010, and August 27, 2010, qualify for a cash incentive payout of between $6,000 and $30,000, depending on base salary and years of service. As of June 30, 2010, 209 eligible PASSHE employees accepted the offer by signing a release and settlement agreement releasing PASSHE from all legal claims related to their employment and retirement. For the year ended June 30, 2010, PASSHE recorded an expense of $3,346,000 for the cash incentive and $256,000 for associated Social Security and Medicare taxes, for a total expense of $3,602,000. The cash incentive is not eligible for retirement benefits. The Association of Pennsylvania State College and University Faculties declined to participate in this program.

In March 2010, the Board approved a Severance for Abolished Positions Program for both union and nonrepresented active, full-time, permanent employees whose positions are abolished (or subject to furlough or seniority bump) on or before September 30, 2010. Eligible employees who sign a release and settlement agreement relinquishing seniority bump, recall, and placement rights receive a severance package of a lump sum cash payout of two, four, or six months of base salary and two, four, or six months of COBRA premiums, depending on years of service. As of June 30, 2010, seven PASSHE employees were notified that their positions were abolished and were offered the severance package. For the year ended June 30, 2010, PASSHE recorded an expense of $110,000 for the lump sum cash payouts and $9,000 for associated Social Security and Medicare taxes, for a total expense of $119,000. The severance payment is not eligible for retirement benefits. Positions abolished under this program may not be backfilled for 24 months and exclude those fully funded by restricted sources (e.g., grants). The Association of Pennsylvania State College and University Faculties and the State College and University Professional Association declined to participate in this program.

(9) Bonds Payable

Bonds payable on June 30, 2010 and 2009, consisted of several outstanding tax-exempt revenue bond series issued by the Pennsylvania Higher Educational Facilities

Authority (PHEFA). In connection with the bond issuance, PASSHE entered into a loan agreement with PHEFA under which PASSHE has pledged its full faith and credit for the repayment of the bonds. The loan constitutes an unsecured general obligation of PASSHE. The bonds were issued to provide funds to undertake various capital projects at the Universities or to advance refund certain previously issued bonds. Activity for the various bond series for the years ended June 30, 2010 and 2009, was as follows.

Bonds Payable
June 30, 2010 and 2009
(in thousands)

Description	Original Issuance	Weighted Average Interest Rate	Balance June 30, 2008	2009 Bonds Issued	2009 Bonds Redeemed/ Refunded	Balance June 30, 2009	2010 Bonds Issued	2010 Bonds Redeemed/ Refunded	Balance June 30, 2010
Series R issued in June 1999, final maturity June 2024	$31,050	4.90%	$19,435	–	$840	$18,595	–	$18,595	–
Series S issued in June 2000, final maturity June 2020	51,720	5.49%	31,475	–	2,880	28,595	–	28,595	–
Series T issued in July 2001, final maturity June 2021	69,555	4.87%	39,235	–	2,665	36,570	–	2,785	$33,785
Series U issued in August 2002, final maturity June 2022	14,400	4.38%	10,115	–	660	9,455	–	675	8,780
Series V issued in August 2002, final maturity June 2022	25,200	N/A	7,990	–	7,990	–	–	–	–
Series W issued in October 2002, final maturity June 2020	69,105	4.74%	63,965	–	1,210	62,755	–	960	61,795
Series X issued in May 2003, final maturity June 2023	80,910	4.37%	50,240	–	6,970	43,270	–	6,950	36,320
Series Y issued in June 2003, final maturity June 2023	25,350	N/A	9,485	–	9,485	–	–	–	–
Series Z issued in March 2004, final maturity June 2024	71,760	3.96%	56,745	–	4,550	52,195	–	4,460	47,735
Series AA issued in July 2004, final maturity June 2024	28,750	4.58%	23,520	–	1,435	22,085	–	1,490	20,595
Series AB issued in July 2004, final maturity June 2024	20,970	N/A	9,230	–	9,230	–	–	–	–
Series AC issued in July 2005, final maturity June 2025	52,650	4.91%	46,260	–	2,300	43,960	–	2,415	41,545
Series AD issued in July 2005, final maturity June 2025	7,310	N/A	6,325	–	6,325	–	–	–	–
Series AE issued in July 2006, final maturity June 2036	103,290	4.99%	97,255	–	3,150	94,105	–	3,310	90,795
Series AF issued in July 2007, final maturity June 2037	68,230	4.93%	66,425	–	1,785	64,640	–	1,860	62,780
Series AG issued in March 2008, final maturity June 2024	101,335	4.53%	99,170	–	4,095	95,075	–	4,245	90,830
Series AH issued in July 2008, final maturity June 2038	140,760	4.69%	–	$140,760	2,980	137,780	–	3,420	134,360
Series AI issued in August 2008, final maturity June 2025	32,115	3.98%	–	32,115	1,515	30,600	–	1,820	28,780
Series AJ issued in July 2009, final maturity June 2039	123,985	4.85%	–	–	–	–	$123,985	2,825	121,160
Series AK issued in September 2009, final maturity June 2024	47,310	3.68%	–	–	–	–	47,310	1,220	46,090
Total	**$1,165,755**		**$636,870**	**$172,875**	**$70,065**	**$739,680**	**$171,295**	**$85,625**	**$825,350**

Principal and interest requirements to maturity are as follows.

(in thousands)

	Principal	Interest	Total
2011	$39,975	$38,185	$78,160
2012	36,950	36,529	73,479
2013	38,470	34,949	73,419
2014	44,735	33,277	78,012
2015	50,995	31,320	82,315
2016–2020	275,780	119,667	395,447
2021–2025	210,645	58,279	268,924
2026–2030	76,435	21,927	98,362
2031–2035	40,695	7,966	48,661
2036–2039	10,670	876	11,546
Total	**$825,350**	**$382,975**	**$1,208,325**

(10) Debt Refundings

In September 2009, the net proceeds from the Series AK revenue bonds were used to refund Series R and advance refund the Series S revenue bonds. This refunding was completed to reduce debt service by approximately $5,012,000 and resulted in an economic gain (difference between the present values of the old and new debt service payments) of approximately $4,762,000.

(11) Capital Assets

The classifications of capital assets and related depreciation at June 30, 2010 and 2009, follow.

(in thousands)

	Balance June 30, 2008	2009 Additions	2009 Retirements/ Adjustments	Balance June 30, 2009	2010 Additions	2010 Retirements/ Adjustments	Balance June 30, 2010
Land	$21,209	$1,598	-	$22,807	$946	$1,017	$24,770
Construction in progress	202,879	122,049	($197,912)	127,016	139,852	(106,987)	159,881
Total capital assets not being depreciated	224,088	123,647	(197,912)	149,823	140,798	(105,970)	184,651
Buildings, including improvements	1,231,193	66,905	118,742	1,416,840	59,323	77,008	1,553,171
Improvements other than buildings	168,431	10,215	14,428	193,074	8,957	9,214	211,245
Equipment and furnishings	322,417	27,243	(2,174)	347,486	23,582	(4,618)	366,450
Library books	82,654	2,763	(1,888)	83,529	2,177	(1,858)	83,848
Total capital assets being depreciated	1,804,695	107,126	129,108	2,040,929	94,039	79,746	2,214,714
Less accumulated depreciation							
Buildings and improvements	(407,014)	(55,862)	9,437	(453,439)	(61,924)	13,311	(502,052)
Land improvements	(70,228)	(10,312)	(1,855)	(82,395)	(9,150)	5,210	(86,335)
Equipment and furnishings	(219,034)	(31,023)	8,410	(241,647)	(31,975)	(1,912)	(275,534)
Library books	(68,804)	(2,869)	1,868	(69,805)	(2,684)	1,845	(70,644)
Total accumulated depreciation	(765,080)	(100,066)	17,860	(847,286)	(105,733)	18,454	(934,565)
Total capital assets being depreciated, net	1,039,615	7,060	146,968	1,193,643	(11,694)	98,200	1,280,149
Capital assets, net	$1,263,703	$130,707	($50,944)	$1,343,466	$129,104	($7,770)	$1,464,800

(12) Contingencies

The nature of the educational industry is such that, from time to time, PASSHE is exposed to various risks of loss related to torts; alleged negligence; acts of discrimination; breach of contract; labor disputes; disagreements arising from the interpretation of laws or regulations; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters.

While some of these claims may be for substantial amounts, they are not unusual in the ordinary course of providing educational services in a higher education system. PASSHE is self-insured for workers' compensation up to stated limits (note 6). For all other risks of loss, PASSHE pays annual premiums to the Commonwealth to participate in its Risk Management Program. PASSHE does not participate in any public entity risk pools, and does not retain risk related to any aforementioned exposure, except for those amounts incurred relative to policy deductibles that are not significant.

PASSHE has not significantly reduced any of its insurance coverage from the prior year. Settled claims have not significantly exceeded PASSHE's insurance coverage in any of the past three years. It is not expected that the resolution of any outstanding claims and litigation will have a material adverse effect on the accompanying financial statements.

(13) Subsequent Events

In July 2010, PHEFA issued Series AL tax-exempt revenue bonds in the amount of $135,410,000. The net proceeds were used to finance various capital projects at the Universities and advance refund the Series T revenue bonds. The refunding reduced debt service by approximately $2,630,000 and resulted in an economic gain (difference between the present values of the old and new debt service payments) of approximately $2,546,000. In connection with the bond issuance, PASSHE entered into a loan agreement with PHEFA under which PASSHE pledged its full faith and credit for repayment of the bonds.

REQUIRED SUPPLEMENTARY INFORMATION

Years ended June 30, 2010 and 2009
(Unaudited)

Schedule of Funding Progress for the System Plan (OPEB)

(in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
July 1, 2007	$0	$1,026,393	$1,026,393	0%	$472,477	217%
July 1, 2008	$0	$1,049,267	$1,049,267	0%	$510,373	206%
July 1, 2009	$0	$1,127,437	$1,127,437	0%	$525,684	214%

Schedule of Funding Progress for the REHP (OPEB)

(in thousands)

The information below relates to the Commonwealth's REHP as a whole, i.e., it is inclusive of all participating Commonwealth agencies and instrumentalities. Nearly all Commonwealth agencies and instrumentalities participate in the REHP.

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
July 1, 2007	$38,500	$7,297,500	$7,259,000	.52%	$3,559,000	203%
July 1, 2008	$60,000	$12,863,270	$12,803,270	.47%	$3,559,000	360%
July 1, 2009	$47,920	$13,257,570	$13,209,650	.36%	$4,093,000	323%

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