PASSHE

Pennsylvania State System of Higher Education

FINANCIAL STATEMENTS
JUNE 30, 2012

UNIVERSITIES OF THE PENNSYLVANIA STATE SYSTEM OF HIGHER EDUCATION

BLOOMSBURG ★ CALIFORNIA ★ CHEYNEY ★ CLARION ★ EAST STROUDSBURG ★ EDINBORO ★ INDIANA ★ KUTZTOWN
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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, 2012 and 2011, 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 $449,013,000 and $455,868,000 as of June 30, 2012 and 2011. 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, 2012 and 2011, and the respective changes in its net assets and its cash flows, where applicable, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 11 and the Required Supplementary Information on page 33 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

ParenteBeard LLC

Wilkes-Barre, Pennsylvania
September 26, 2012

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 more than 118,000 students enrolled, PASSHE is the state's largest higher education provider. Its 14 universities offer the lowest-cost four-year baccalaureate degree programs in the state 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 financial activities for the year ended June 30, 2012, as compared to the year ended June 30, 2011.

FINANCIAL HIGHLIGHTS

- In fiscal year 2011/12, PASSHE received $412.8 million in General Fund **appropriations** from the Commonwealth, a decrease of $52.4 million, or 11.3%, from the General Fund appropriations received in fiscal year 2010/11.

- PASSHE received **no funding from ARRA** (American Recovery and Reinvestment Act) State Fiscal Stabilization Funds in fiscal year 2011/12. The Commonwealth had supplemented its appropriation to PASSHE with $38.2 million of ARRA funds in fiscal year 2010/11 and $65.2 million in ARRA funds in fiscal year 2009/10.

- Including the ARRA funds, PASSHE's **appropriation decreased $90.6 million**, or 18%, in fiscal year 2011/12 compared to fiscal year 2010/11. This is the same level of funding PASSHE received in fiscal year 1997/98—fourteen years ago.

- After a two-year suspension, PASSHE received a $6.8 million Realty Transfer Tax allocation from the Commonwealth's **Key '93** (Keystone Recreation, Park and Conservation) Fund. With the exception of the last two years, Key '93 funds have provided a consistent revenue stream for deferred maintenance projects since 1993. PASSHE has received $11.7 million of Key '93 funds in fiscal year 2012/13.

- From fiscal year 2000/01 to fiscal year 2008/09, PASSHE received $65 million annually in **Commonwealth capital funding**, primarily for renovation or replacement of existing educational and general buildings. In fiscal years 2009/10 and 2010/11, the Commonwealth's capital funding for PASSHE increased to $130 million per year. In fiscal year 2011/12, however, the Governor reduced PASSHE's capital appropriation funding level back to $65 million, where it will remain for the foreseeable future. The portion of capital appropriations reflected in these statements, representing the furnishings and equipment for the Commonwealth-funded construction projects, totaled $9.7 million and $1.3 million in fiscal years 2011/12 and 2010/11, respectively.

- As part of its continuing commitment to reward the universities for demonstrated success and continued improvement in student achievement, university excellence, and operational efficiency, PASSHE's Board of Governors (Board) allocated $35.9 million of PASSHE's appropriations for **performance funding** in fiscal year 2011/12, slightly more than the $35.6 million allocated in fiscal year 2010/11.

- After 14 years of record growth, PASSHE experienced its **first enrollment decline** in fiscal year 2011/12. Fall 2011 enrollment was 118,224, a decrease of 1,289 students, or 1%, from the fall 2010 record enrollment of 119,513.

- Of the 118,224 **students** in the fall 2011 enrollment, 100,459 (85%) were full-time and 17,765 (15%) were part-time students; 102,900 (87%) were undergraduate and 15,324 (13%) were graduate students.

- In academic year 2010/11, PASSHE awarded 24,860 **degrees**, comprising 18,485 bachelor's degrees; 5,630 master's degrees; 150 doctoral degrees; 388 associate's degrees; and 207 certificates.

- The Board approved a **tuition rate increase** of 7.5%, or $436, for undergraduate resident students in fiscal year 2011/12. PASSHE's 2011/12 annual tuition rate of $6,240 for full-time, resident undergraduate students was the lowest of four-year baccalaureate degree programs in the state.

- **Mandatory student fees** set by the universities increased, on average, by 9.4%. These increases resulted in tuition and fee revenue (before discounts) of $1.01 billion, an increase of $77.1 million, or 8.3%, over fiscal year 2010/11.

- The most common **room and board fees** (included in auxiliary enterprises) set by the universities increased 4.7% and 1.4%, respectively, resulting in revenue of $246.9 million, an increase of $1.3 million, or 0.5%, over fiscal year 2010/11.

- PASSHE's **average cost of attendance** (tuition, mandatory fees, room, and board) in 2011/12 was $513 below the average among all four-year public universities in the United States and $2,317 below the average in the Middle States region (Delaware, Maryland, New Jersey, New York, Pennsylvania, and Washington, D.C.), according to the latest College Board survey.

- PASSHE purchased $187.0 million in **capital assets** in fiscal year 2011/12, including $150.3 million to build or improve academic and auxiliary facilities across all 14 universities.

- On July 12, 2011, PASSHE issued Series AM bonds totaling $119.1 million to provide funds to undertake various **capital projects at the universities**, including:

  - $23.6 million for student residences at Bloomsburg, Indiana, and Lock Haven;
  - $51.9 million for student union/recreation centers at Millersville, Shippensburg, Slippery Rock, and West Chester;
  - $12.7 million for technology infrastructure and information systems at California and East Stroudsburg;
  - $3.1 million for a Guaranteed Energy Savings Agreement project at Millersville;
  - $14.6 million for the convocation center at California;
  - $5.4 million for a performing arts center at Millersville; and
  - $7.8 million for property purchases by East Stroudsburg.

- In March 2012, PASSHE issued Series AN revenue bonds totaling $76.8 million to current refund Series U, W, and X revenue bonds. This **bond refunding** was completed to reduce debt service by $13.8 million and resulted in an economic gain (difference between the present values of the old and new debt service payments) of approximately $13.3 million.

- During fiscal year 2011/12, $48.0 million of principal and $6.8 million of interest was paid, bringing the total outstanding **bond debt** to $941.7 million at June 30, 2012.

- **Moody's Rating**
  In February 2012, Moody's Investors Service, Inc. (Moody's), assigned PASSHE a **bond rating of Aa2**. Moody's ratings outlook for PASSHE is *Negative*. In its analysis of PASSHE, Moody's notes PASSHE's strengths and challenges as follows:

  Strengths
  - PASSHE's established market position and its large enrollment base.
  - Improved, balanced operating performance and cash flow generation.
  - Adequate financial resource cushion of debt and operations with rapid amortization of debt.
  - Good unrestricted liquidity.

  Challenges
  - Declining enrollment, particularly in Western Pennsylvania, with an ongoing decline in the number of Pennsylvania high school graduates.
  - Dramatic increase in privatized replacement student housing debt, over which PASSHE has limited oversight, and which creates a strong strategic and operational link between PASSHE and its affiliates.
  - A highly unionized environment.
  - Rising pension and health care benefits that have created a high postretirement liability.
  - Expected continued reductions in operating support from the Commonwealth.

THE FINANCIAL STATEMENTS

The *Balance Sheet* 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**.

The *Statement of Revenues, Expenses, and Changes in Net Assets* 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.

The *Statement of Cash Flows* provides 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 meet its obligations as they come due and its need for external financing.

Net Assets

In accordance with GASB requirements, PASSHE reports three components of net assets:

- *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 $72.9 million to $864.4 million for the year ended June 30, 2012. 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 $6.4 million to $108.2 million for the year ended June 30, 2012. 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.

Overall, net assets increased by $71.6 million in fiscal year 2011/12, compared to an increase of $53.9 million in fiscal year 2010/11.

Following is a summary of the balance sheet at June 30, 2012, 2011, and 2010.

(in millions)

Balance Sheet

	June 30, 2012	Change from Prior Year	June 30, 2011	Change from Prior Year	June 30, 2010	Change from Prior Year
Assets						
Cash and investments	$1,340.3	11.7%	$1,199.9	6.5%	$1,126.3	9.7%
Capital assets, net	1,623.4	4.6%	1,551.9	5.9%	1,464.8	9.0%
Other assets	181.1	(9.5%)	200.2	18.5%	168.9	12.1%
Total assets	$3,144.8	6.5%	$2,952.0	7.0%	$2,760.0	9.5%
Liabilities						
Workers' compensation	$19.8	4.2%	$19.0	15.2%	$16.5	4.4%
Compensated absences	108.2	6.3%	101.8	(2.1%)	104.0	4.4%
Postretirement benefits	864.4	9.2%	791.5	9.5%	722.6	9.1%
Bonds payable	941.7	6.4%	885.3	7.3%	825.4	11.6%
Other liabilities	398.0	(3.7%)	413.3	2.2%	404.3	12.5%
Total liabilities	2,332.1	5.5%	2,210.9	6.7%	2,072.8	10.4%
Net Assets						
Invested in capital assets, net of related debt	621.4	3.3%	601.6	(2.3%)	615.9	7.9%
Restricted	86.2	12.7%	76.5	12.7%	67.9	0.0%
Unrestricted*	105.1	66.8%	63.0	1,752.9%	3.4	(27.7%)
Total net assets	812.7	9.7%	741.1	7.8%	687.2	6.8%
Total liabilities and net assets	$3,144.8	6.5%	$2,952.0	7.0%	$2,760.0	9.5%

**$27.5 million of the change in Unrestricted net assets from June 30, 2010, to June 30, 2011, was due to university reclassification from Invested in capital assets, net of related debt.*

Revenues and Expenses

Overall, fiscal year 2011/12 **operating revenues increased 6.6%** from the prior fiscal year, mainly due to the 8.7% increase in net tuition and fees. Nonoperating revenues decreased 13.6%, primarily because of the overall 16.3% decrease in state appropriations.

In anticipation of a significant decrease in funding from the Commonwealth, along with concerns about tuition rates and declining enrollment, **universities cut operating expenses by $9 million**, or 0.5%, in fiscal year 2011/12 compared to the prior fiscal year.

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:

- **Investment income** (before investment expenses) for fiscal year 2011/12 was $24.9 million, an increase of $0.5 million from the prior year. Although the decline in interest rates continued through the fiscal year, spending at the universities declined, resulting in higher operating capital. The average monthly operating capital was approximately $128 million more, or 12% higher, than the previous fiscal year.

- Universities spent $683.4 million on **instruction**, or 36.7% of total operating expenses, in fiscal year 2011/12. This represents a decrease of $13.3 million, or 1.9%, over fiscal year 2010/11.

- **Financial aid** to students in the form of waivers and scholarships was $301.6 million in fiscal year 2011/12, an increase of $11.6 million from the previous year. In accordance with a formula prescribed by the National Association of College and University Business Officers (NACUBO), in fiscal year 2011/12, PASSHE reported $223.9 million of financial aid as *scholarship discounts and allowances* (netted against tuition and fees) and $76.6 million as *student aid* expense. Auxiliary expense was reported as $1.1 million. Following is the breakdown of scholarship discounts and allowances and waivers in fiscal years 2011/12 and 2010/11:

(in millions)

Student Financial Aid

	2011/12	**2010/11**
Federal Pell grants	$145.7	$149.0
Other federal aid	6.2	12.4
State financial aid including PHEAA	104.0	82.1
Local government financial aid	1.7	1.9
Scholarships from endowments and restricted gifts and grants	10.3	9.8
Unrestricted scholarships and fellowships	12.0	11.9
Tuition and fee waivers	20.6	22.0
Dorm and dining waivers	1.1	0.9
Total	$301.6	$290.0

- **Interest expense** on capital asset-related debt was $41.6 million, an increase of $5.2 million over fiscal year 2010/11.

- PASSHE is the 15th largest employer in the state (*source: PA Department of Labor and Industry*), with more than 13,038 professional and support staff. **Salaries and benefits** totaled $1.26 billion. Compared to fiscal year 2010/11, salaries decreased by $23.7 million, or 2.7%, while benefits increased by $6.0 million, or 1.5%, for an overall decrease of $17.7 million:

  - Employer **hospitalization and Health and Welfare Fund** costs decreased 6.1% over fiscal year 2010/11, for a total decrease of $7.4 million. This follows a decrease of 1.5% ($1.8 million) in fiscal year 2010/11 and an increase of 15.6% ($16.6 million) in fiscal year 2009/10 over the prior fiscal years.

  - Employer **annuitant health care** costs increased 6.9% over fiscal year 2010/11, for a total increase of $8.7 million. This follows consecutive increases of 7.8% ($9.1 million) and 4.9% ($5.5 million) in fiscal years 2010/11 and 2009/10, 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.

  - Employer contributions to **SERS and PSERS** increased 54.4% over fiscal year 2010/11, for a total increase of $7.9 million. This follows consecutive increases of 30.4% ($3.4 million) and 4.8% ($0.5 million) in fiscal years 2010/11 and 2009/10, respectively, over the prior fiscal years. The steep increases were instituted by SERS and PSERS to fund the enormous and growing unfunded actuarial accrued liabilities in both pensions, which was $14.7 billion at December 31, 2011, for SERS and $19.7 billion at June 30, 2011, for PSERS.

  - The total cost for **all other employee benefits**, such as Social Security and workers' compensation, decreased by a total of $3.2 million, or 2.3% less than fiscal year 2010/11, compared to an increase of $4.9 million in fiscal year 2010/11, or 3.6%, over fiscal year 2009/10.

Following is a summary of salaries, wages, and benefits expenses for the years ending June 30, 2012, 2011, and 2010.

(in millions)

Salaries, Wages, and Benefits

	June 30, 2012	Change from Prior Year	June 30, 2011	Change from Prior Year	June 30, 2010	Change from Prior Year
Salaries and wages	$853.9	(2.7%)	$877.7	1.8%	$861.8	3.2%
Benefits						
Hospitalization	104.8	(7.0%)	112.6	(1.4%)	114.2	16.9%
Health & Welfare Fund	8.8	5.0%	8.4	(2.0%)	8.5	0.2%
Annuitant Hospitalization	134.9	6.9%	126.2	7.8%	117.1	4.9%
SERS	20.6	58.4%	13.0	28.0%	10.2	4.2%
PSERS	1.8	19.5%	1.5	56.3%	1.0	11.2%
Other benefits	137.3	(2.3%)	140.5	3.6%	135.6	4.1%
Total benefits	408.2	1.5%	402.2	4.0%	386.6	7.8%
Total salaries, wages, and benefits	$1,262.1	(1.4%)	$1,279.9	2.5%	$1,248.4	4.6%

Following are summaries of revenues and expenses for the years ending June 30, 2012, 2011, and 2010.

(in millions)

Revenues

	June 30, 2012	Change from Prior Year	June 30, 2011	Change from Prior Year	June 30, 2010	Change from Prior Year
Operating revenues						
Tuition and fees, net	$786.4	8.7%	$723.5	8.4%	$667.4	4.6%
Grants and contracts	320.7	1.7%	315.3	4.5%	301.7	19.7%
Auxiliary enterprises, net	327.1	2.5%	319.0	8.4%	294.2	5.1%
Other	56.8	38.6%	40.8	9.7%	37.3	(0.3%)
Total operating revenues	1,491.0	6.6%	1,398.6	7.5%	1,300.6	7.7%
Nonoperating revenues						
State appropriations	422.5	(16.3%)	504.7	(5.3%)	532.8	4.7%
Investment income, net	24.5	2.1%	24.0	(14.0%)	27.9	(21.2%)
Unrealized gain on investment	11.7	91.8%	6.1	(61.6%)	15.9	(762.5%)
Gifts and other	28.6	(2.0%)	29.3	12.3%	26.1	13.5%
Total nonoperating revenues	487.3	(13.6%)	564.1	(6.4%)	602.7	6.7%
Total revenues	$1,978.3	0.8%	$1,962.7	3.1%	$1,903.3	7.4%

(in millions)

Expenses

	June 30, 2012	Change from Prior Year	June 30, 2011	Change from Prior Year	June 30, 2010	Change from Prior Year
Operating expenses						
Instruction	$683.4	(1.9%)	$696.7	4.9%	$664.2	5.2%
Research	6.6	(7.0%)	7.1	0.0%	7.1	(2.7%)
Public service	33.8	(5.1%)	35.6	(2.2%)	36.4	(10.6%)
Academic support	158.9	(0.1%)	159.0	(3.5%)	164.8	(0.5%)
Student services	166.3	1.0%	164.6	6.1%	155.1	3.6%
Institutional support	251.4	0.7%	249.6	1.4%	246.2	2.4%
Operations and maintenance of plant	137.1	(2.3%)	140.3	0.1%	140.2	(3.0%)
Depreciation	113.2	4.6%	108.2	2.4%	105.7	5.6%
Student aid	76.6	(3.8%)	79.6	3.5%	76.9	28.0%
Auxiliary enterprises	235.5	1.9%	231.1	5.0%	220.2	2.6%
Total operating expenses	1,862.8	(0.5%)	1,871.8	3.0%	1,816.8	3.6%
Other expenses						
Interest expense on capital asset-related debt	41.6	14.3%	36.4	4.0%	35.0	10.1%
Loss on disposal of assets	2.3	283.3%	.6	(91.8%)	7.3	(83.8%)
Total other expenses	43.9	18.6%	37.0	(12.5%)	42.3	(44.9%)
Total expenses	$1,906.7	(0.1%)	$1,908.8	2.7%	$1,859.1	1.5%

FUTURE ECONOMIC FACTORS

- The **Commonwealth** ended fiscal year 2011/12 with General Fund collections that were $162.8 million, or 0.6%, below estimate. Similar revenue collections are anticipated in the Commonwealth's fiscal year 2012/13 General Fund budget. The Governor's Program Policy Guidelines for preparation of the 2013/14 Commonwealth budget again states that "the Pennsylvania economy is still in recovery and has not yet emerged from the 'Great Recession.'" It is anticipated that the Commonwealth's mandatory expenditure increases, including pensions, medical assistance, corrections, and debt service, will continue to grow at a faster rate than revenue.

- In fiscal year 2012/13, PASSHE will receive $412.8 million in **General Fund appropriations**, the same as received in fiscal year 2011/12. This funding level is approximately the same as the appropriations PASSHE received from the Commonwealth in fiscal year 1997/98.

- The Commonwealth has continued its commitment to fund PASSHE's deferred maintenance projects with a Realty Transfer Tax allocation from the **Key '93** funds. PASSHE received $11.7 million from this revenue stream in 2012/13. Key '93 funds are derived from the Realty Transfer Tax; the actual amount received is an estimate and may be adjusted based upon the health of the real estate market.

- The Board approved a 3.0% **increase in tuition** for the 2012/13 academic year. The $188 increase for full-time, resident undergraduate students sets the new rate at $6,428, the lowest among all four-year colleges and universities in Pennsylvania.

- After 14 straight years of record **enrollments**, some universities experienced reductions in academic year 2011/12 enrollment, resulting in a 1% decline in PASSHE's overall fall headcount enrollment. Contributing factors are the general economic environment and declining numbers of high school graduates. In addition, changes in state and local policies regarding advanced degrees for teachers contributed to an overall decline in graduate enrollment. Preliminary fall 2012 enrollment statistics indicate a continuing enrollment decline of approximately 3%.

- During fiscal year 2011/12, PASSHE increased its focus on **enrollment management**:

- o PASSHE is conducting a pricing elasticity and brand value study. It is anticipated the results of this study will provide guidance for improving institutional brand strength and optimizing the relationship between market demand and net price.

- o PASSHE is creating a System-wide, multiuniversity, electronic admissions application. Anticipated to be available for use by the fall 2014 entering class, this web-based tool should result in increased admissions applications and provide a better showcase of PASSHE offerings to prospective students.

- o Initiatives designed for nontraditional and returning adult students are underway and include articulation agreements in 25 areas of study with Pennsylvania's 14 community colleges. In addition, PASSHE is collaborating with the Center for Adult and Experiential Learning to assist students in developing "prior learning portfolios" for college credit.

- o Several PASSHE universities have created senior leadership positions in enrollment management.

- o PASSHE continues to align academic offerings with work force needs and student expectations. In 2011/12 alone, the Board created 18 new academic programs, placed 29 programs in moratorium, discontinued 4 programs, and reorganized 20 programs.

- In fiscal year 2011/12, the State Employees' Retirement System (SERS) continued its steep increases in employer **pension contribution rates** that are anticipated to persist through fiscal year 2013/14 and remain high for the foreseeable future. The most predominant employer-paid SERS rates for PASSHE employees rose 50% in 2012/13, and are anticipated to increase 43% in 2013/14. A similar pattern is occurring with the Public School Employees' Retirement System (PSERS). Approximately 47% of PASSHE's employees receiving retirement benefits are enrolled in SERS or PSERS.

- In June 2012, GASB issued Statement No. 67, *Accounting and Financial Reporting for Pensions*. Statement 67 will require PASSHE to report on its balance sheet a net **pension liability for SERS and PSERS**, which would represent the difference between its share of the total SERS and PSERS pension liabilities and the net assets set aside in a qualified trust to pay the benefits to current employees, retirees, and their beneficiaries. Although an estimate of the liability has not been calculated by SERS or PSERS, the effect on PASSHE is expected to be significant. PASSHE will begin recording this liability in fiscal year 2014/15.

  - o At December 31, 2011, SERS' actuarial accrued pension liability of $42.3 billion was only 65.3% funded, down from 75.2% funded the previous year. The actuarial value of its net assets was $27.6 billion at December 31, 2011, compared to $29.4 billion at December 31, 2010, a decrease of $1.8 billion. $14.7 billion of its actuarial pension liability was unfunded at December 31, 2011, compared to $9.7 billion unfunded at December 31, 2010. The $14.7 billion is debt already incurred by the Commonwealth, and it is an obligation that cannot be eliminated by reducing future benefits. The 2011 employer contributions were only 42.8% of the actuarially calculated Annual Required Contribution. The number of new retirees added to the SERS rolls in 2011 (7,669) was 90% higher than those removed from the rolls (4,040), increasing the annual allowance paid to retirees to $2.2 billion, or 7.4% higher than 2010. In 2011, PASSHE's employees represented 4.8% of active SERS members. SERS predicts that it may take as many as 40 years to fully fund its liability.

  - o At June 30, 2011, PSERS's actuarial accrued pension liability of $79.1 billion was only 75.1% funded, down from 79.2% funded the previous year. The actuarial value of its net assets was $59.4 billion at June 30, 2011, compared to $59.9 billion at June 30, 2010, a decrease of $0.5 billion. $19.7 billion of its actuarial pension liability was unfunded at June 30, 2011, compared to $15.7 billion unfunded at June 30, 2010. The $19.7 billion is debt already incurred and cannot be eliminated by reducing future benefits. The 2011 employer contributions were only 27% of the actuarially calculated Annual Required Contribution. PASSHE's employees represent approximately 0.4% of reported member salaries covered under PSERS.

- PASSHE has eight **collective bargaining agreements** with seven employee unions. Agreements have yet to be reached with three bargaining units, whose contracts expired June 30, 2011, meaning that future compensation requirements are unknown for approximately 53% of PASSHE's employees.

- **Moody's Outlook**
  As a result of the recent downgrade of the Commonwealth of Pennsylvania's rating from Aa1 to Aa2, Moody's notified PASSHE that its rating was under a 90-day review for a **possible downgrade**. A decision on whether PASSHE's rating will be changed is expected in October 2012. Moody's notes the following regarding a change in the rating.

  What could make the rating go up (not likely with the negative outlook):
  - Substantial increase in financial resources, including a notable rise in gift revenues.
  - Consistently favorable operating performance.
  - Increased student demand.

  What could make the rating go down:
  - Stagnant or declining tuition revenues.
  - Failure to achieve significant gains in union contract negotiations.
  - Substantially reduced state funding.
  - Further increase in debt.

- On February 6, 2012, Governor Tom Corbett created an **Advisory Commission on Postsecondary Education** to make recommendations related to the Commonwealth's postsecondary education system. The review, to be completed by November 15, 2012, will include "an assessment of state workforce shortages, system sustainability and adaptability, individual sector roles and responsibilities and funding policies." Concurrently, PASSHE's Board is in the process of developing a new strategic plan. It is anticipated that PASSHE's strategic plan will take into consideration the deliberations of the Commonwealth Commission.

- PASSHE was successful in achieving a number of statutory changes this spring, known collectively as the **Higher Education Modernization Act**. These changes in legislation:

  - Enhance economic development opportunities for PASSHE universities, faculty, and students by allowing employees and students to participate in entrepreneurial activity related to marketable intellectual property and services developed by faculty.
  - Allow university employees to engage in fundraising activities with affiliated organizations.
  - Allow all PASSHE universities to offer applied doctorates (previously, only Indiana University could do so).
  - Allow PASSHE to join nonprofit, interstate, multiuniversity procurement consortia.

- PASSHE's **accountability and performance funding** programs, which have been in place since 2001, have been drivers for change to better serve students and the Commonwealth. 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 has created a culture of accountability throughout PASSHE, serving as a national model for accountability and institutional improvement. To build upon these successes, the program has been redesigned to improve student success, access to PASSHE universities, and stewardship of public resources. To achieve these principles, each institution has committed to ten performance indicators for the next five years, beginning July 2012. Five of the indicators are the same for all universities; the remaining five vary by university, recognizing institutional differences. University performance will be measured based upon institutional improvement and national standards/goals or peer comparisons. These measures align with the requirements of the Middle States Commission on Higher Education and with national accountability efforts such as Complete College America and the EdTrust/NASH Access to Success initiative. PASSHE is committed to funding its performance program at a level equal to 2.4% of the Educational and General (E&G) budget.

- Construction of **PennREN** (Pennsylvania Research and Education Network), a high-speed broadband network, continues on schedule with a completion date of 2013. Once completed, PennREN will form interconnections among the vast majority of higher education institutions, provide new opportunities to partner with K-12 schools, increase access to national and federal research centers, and enhance the availability of telemedicine and the use of electronic medical records. PennREN was initiated by the Keystone Initiative for Network Based Education and Research (KINBER), a historic collaboration comprising PASSHE, other Pennsylvania colleges and universities, research and health care organizations, and economic development entities.

- For **further information** about these financial statements, contact the Pennsylvania State System of Higher Education, Accounting Office, 2986 North Second Street, Harrisburg, PA 17110.

Pennsylvania State System of Higher Education

Balance Sheet

(dollars in thousands)

Assets

	June 30, 2012	June 30, 2011
Current Assets		
Cash and cash equivalents	$ 23,713	$ 18,353
Short-term investments	431,145	406,953
Accounts receivable, students, net of allowance for doubtful accounts of $22,462 in 2012 and $20,611 in 2011	50,127	51,719
Accounts receivable, other	10,743	19,528
Governmental grants and contracts receivable	54,394	39,873
Inventories	3,863	3,798
Prepaid expenses	8,654	8,755
Current portion of loans receivable	5,302	5,312
Due from component units	1,191	8,055
Other current assets	3,436	14,957
Total Current Assets	592,568	577,303
Noncurrent Assets		
Restricted cash and cash equivalents	25	3,812
Endowment investments	27,679	26,935
Other long-term investments	857,690	743,827
Due from component units	11,581	10,549
Loans receivable, net of allowance for doubtful accounts of $6,047 in 2012 and $4,978 in 2011	29,120	30,848
Capital Assets:		
Land	27,606	26,304
Buildings, including improvements	1,888,922	1,687,780
Improvements other than buildings	232,226	223,831
Equipment and furnishings	425,040	388,202
Library books	83,960	83,810
Construction in progress	92,627	175,278
	2,750,381	2,585,205
Less accumulated depreciation	(1,126,994)	(1,033,267)
Capital assets, net	1,623,387	1,551,938
Other noncurrent assets	2,786	6,778
Total Noncurrent Assets	2,552,268	2,374,687
Total Assets	$ 3,144,836	$ 2,951,990

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Balance Sheet

(dollars in thousands)

Liabilities and Net Assets

	June 30, 2012	June 30, 2011
Current Liabilities		
Accounts payable and accrued expenses	$ 151,992	$ 192,694
Deferred revenue	57,602	53,044
Deposits	9,337	17,388
Current portion of workers' compensation liability	4,755	4,895
Current portion of compensated absences liability	11,656	10,269
Current portion of postretirement benefits liability	56,635	52,604
Current portion of capitalized lease obligations	8,893	3,441
Current portion of bonds payable	41,913	41,260
Other current liabilities	43,230	34,959
Total Current Liabilities	386,013	410,554
Noncurrent Liabilities		
Deferred revenue	3,545	5,075
Deposits	362	2,351
Workers' compensation liability	15,008	14,090
Compensated absences liability	96,550	91,559
Postretirement benefits liability	807,760	738,848
Capitalized lease obligations	46,627	42,995
Bonds payable	899,802	844,030
Other noncurrent liabilities	76,442	61,375
Total Noncurrent Liabilities	1,946,096	1,800,323
Total Liabilities	2,332,109	2,210,877
Net Assets		
Invested in capital assets, net of related debt	621,400	601,613
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	24,305	24,059
Other	1,251	1,365
Expendable:		
Scholarships and fellowships	12,699	13,013
Research	731	1,685
Student loans	432	416
Capital projects	38,030	27,847
Other	8,771	8,116
Unrestricted	105,108	62,999
Total Net Assets	812,727	741,113
Total Liabilities and Net Assets	$ 3,144,836	$ 2,951,990

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, 2012 and 2011

(dollars in thousands)

	2012		2011	
Operating Revenues				
Tuition and fees	$ 1,010,294		$ 933,153	
Less scholarship discounts and allowances	(223,877)		(209,663)	
Net tuition and fees		$ 786,417		$ 723,490
Governmental grants and contracts:				
Federal		192,150		202,754
State		117,550		101,036
Local		4,027		3,324
Nongovernmental grants and contracts		6,966		8,140
Sales and services		33,535		30,699
Auxiliary enterprises, net of discounts of $659 in 2012 and $498 in 2011		327,139		319,005
Other revenues		23,205		10,173
Total Operating Revenues		1,490,989		1,398,621
Operating Expenses				
Instruction		683,429		696,677
Research		6,591		7,072
Public service		33,844		35,603
Academic support		158,935		159,010
Student services		166,300		164,644
Institutional support		251,352		249,552
Operations and maintenance of plant		137,128		140,311
Depreciation		113,154		108,172
Student aid		76,592		79,580
Auxiliary enterprises		235,488		231,147
Total Operating Expenses		1,862,813		1,871,768
Operating Loss		(371,824)		(473,147)
Nonoperating Revenues (Expenses)				
State appropriations, general and restricted		412,751		465,197
ARRA State Fiscal Stabilization Funds		-		38,158
Investment income, net of related investment expense of $434 in 2012 and $475 in 2011		24,465		23,966
Unrealized gain on investments		11,687		6,092
Gifts for other than capital purposes		15,362		17,259
Interest expense on capital asset-related debt		(41,617)		(36,372)
Loss on disposal of assets		(2,312)		(601)
Other nonoperating revenue		1,308		1,417
Net Nonoperating Revenues		421,644		515,116
Income before other revenues		49,820		41,969
State appropriations, capital		9,748		1,337
Capital gifts and grants		12,046		10,581
Increase in Net Assets		71,614		53,887
Net assets—beginning of year		741,113		687,226
Net assets—end of year		$ 812,727		$ 741,113

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Statement of Cash Flows
For the Years Ended June 30, 2012 and 2011

(dollars in thousands)

	2012	2011
Cash Flows from Operating Activities		
Tuition and fees	$ 786,282	$ 720,409
Grants and contracts	308,308	307,090
Payments to suppliers for goods and services	(406,141)	(422,047)
Payments to employees	(1,216,389)	(1,206,122)
Loans issued to students	(5,153)	(4,273)
Loans collected from students	6,746	6,253
Student aid	(77,033)	(79,800)
Auxiliary enterprise charges	326,124	320,502
Sales and services	33,136	25,958
Other receipts	23,576	10,583
Net cash used in operating activities	(220,544)	(321,447)
Cash Flows from Noncapital Financing Activities		
State appropriations, including Federal ARRA	412,751	503,355
Gifts for other than capital purposes	15,306	16,969
PLUS, Stafford, and other loans receipts (non-Perkins)	890,468	822,304
PLUS, Stafford, and other loans disbursements (non-Perkins)	(890,396)	(822,368)
Agency transactions, net	13,632	(10,243)
Other	1,308	1,419
Net cash provided by noncapital financing activities	443,069	511,436
Cash Flows from Capital Financing Activities		
Proceeds from capital debt and leases	202,982	149,424
Capital appropriations	8,338	564
Capital grants and gifts received	9,792	9,954
Proceeds from sales of capital assets	36	190
Purchases of capital assets	(167,345)	(187,033)
Principal paid on capital debt and leases	(144,200)	(78,820)
Interest paid on capital debt and leases	(27,973)	(41,023)
Net cash used in capital financing activities	(118,370)	(146,744)
Cash Flows from Investing Activities		
Proceeds from sales and maturities of investments	23,828,180	24,201,114
Interest on investments	24,472	24,860
Purchase of investments	(23,955,234)	(24,259,057)
Net cash used in investing activities	(102,582)	(33,083)
Net Increase (Decrease) in Cash and Cash Equivalents	1,573	10,162
Cash and cash equivalents—beginning of year	22,165	12,003
Cash and cash equivalents—end of year	$ 23,738	$ 22,165

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Statement of Cash Flows
For the Years Ended June 30, 2012 and 2011
(dollars in thousands)

	2012	2011
Reconciliation of Operating Loss to Net Cash Used in Operating Activities		
Operating loss	$ (371,824)	$ (473,147)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	113,154	108,172
Expenses paid by Commonwealth or donor	1,344	570
Changes in assets and liabilities:		
Receivables, net	(12,619)	(11,206)
Inventories	(64)	34
Other assets	15,047	(12,792)
Accounts payable	(44,791)	(8,141)
Deferred revenue	340	2,733
Student deposits	658	(1,066)
Compensated absences	6,377	(2,214)
Loans to students and employees	1,593	1,979
Other liabilities	70,241	73,631
Net cash used in operating activities	$ (220,544)	$ (321,447)
Noncash Capital Financing Activities		
Capital assets included in payables or acquired by gift	$ 6,395	$ 8,653
Capital assets acquired through capital leases	$ 13,259	$ 2,282

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Component Units Statement of Financial Position

(dollars in thousands)

	June 30, 2012	June 30, 2011
Assets		
Cash and cash equivalents	$ 111,029	$ 140,014
Accounts receivable	4,792	6,302
Contributions/pledges receivable	19,122	20,815
Due from universities	52,104	40,020
Inventories	9,279	8,307
Short-term investments	29,606	42,706
Investments	336,422	285,032
Capital assets:		
Land	25,216	22,983
Buildings	916,314	769,023
Building improvements	14,909	14,665
Improvements other than buildings	8,597	7,640
Equipment and furnishings	68,028	56,772
Construction in progress	73,656	101,673
	1,106,720	972,756
Less accumulated depreciation	(159,507)	(128,675)
Capital assets, net	947,213	844,081
Other assets	102,804	81,751
Total Assets	$ 1,612,371	$ 1,469,028
Liabilities		
Accounts payable and accrued expenses	$ 37,767	$ 39,872
Annuity liabilities	8,699	8,711
Due to universities	22,868	26,493
Deposits payable	16,398	13,632
Capitalized leases	32,620	17,732
Bonds payable	909,170	755,719
Notes payable	218,730	251,799
Other liabilities	130,050	67,499
Total Liabilities	1,376,302	1,181,457
Net Assets		
Unrestricted	(31,481)	25,637
Temporarily restricted	70,018	74,917
Permanently restricted	197,532	187,017
Total Net Assets	236,069	287,571
Total Liabilities and Net Assets	$ 1,612,371	$ 1,469,028

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Component Units Statement of Activities
For the Years Ended June 30, 2012 and 2011

(dollars in thousands)

	2012	2011
Revenues and Gains		
Contributions	$ 33,921	$ 37,226
Sales and services	49,360	52,684
Student fees	33,753	32,993
Grants and contracts	11,171	13,528
Rental income	111,953	96,711
Investment income	8,133	11,230
Unrealized gains (losses) related to investment activity	(58,089)	35,130
Other revenues and gains	13,045	17,447
Total Revenues and Gains	203,247	296,949
Expenses and Losses		
Program services:		
Scholarships and grants	10,501	10,755
Student activities and programs	28,278	27,877
University stores	32,068	35,639
Housing	110,144	97,871
Other university support	21,364	17,514
Other programs	20,278	27,255
Management and general	24,736	23,393
Fundraising	7,380	9,319
Total Expenses and Losses	254,749	249,623
Change in Net Assets	(51,502)	47,326
Net assets—beginning of year	287,571	240,245
Net assets—end of year	$ 236,069	$ 287,571

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

Years Ended June 30, 2012 and 2011

(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, the activity of the organization is significant to PASSHE universities, and PASSHE historically has received a majority of these economic resources. 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. The economic resources measurement focus reports all inflows, outflows, and balances that affect an entity's net assets. Under the accrual basis of accounting, 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.

Operating Revenues and Expenses

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 to be 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. PASSHE classifies investments as short-term when they are readily marketable and intended to be converted to cash within one year.

Accounts and Loans Receivable
Accounts and loans 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 and loans 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. Library books are capitalized and depreciated. Assets under capital leases are recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. 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. Amortization of assets under capital leases is included in depreciation expense. Normal repair and maintenance expenditures are not capitalized because they neither add to the value of the property nor materially prolong its useful life.

PASSHE does not capitalize collections of art, rare books, historical items, etc., as they are held for public exhibition, education, or research rather than financial gain.

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 years ended June 30, 2012 and 2011.

Deferred Revenue
Deferred revenue includes amounts for tuition and fees, grants, corporate sponsorship payments, and certain auxiliary activities received prior to the end of the fiscal year but earned in a subsequent accounting period.

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.

Scholarships and Waivers
In accordance with a formula prescribed by the National Association of College and University Business Officers (NACUBO), PASSHE allocates the cost of scholarships, waivers, and other student financial aid between *Scholarship discounts and allowances* (netted against tuition and fees) and *Student aid expense*. Scholarships and waivers of room and board fees are reported in Auxiliary enterprises. The cost of tuition waivers granted to employees is reported as employees' benefits expense.

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, 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 November 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. Statement No. 60 establishes guidance for accounting and financial reporting for service concession arrangements, which are a type of public-private or public-public partnership. PASSHE is required to adopt Statement No. 60 for the fiscal year ending June 30, 2013. PASSHE has not yet determined the effect of Statement No. 60 on its financial statements.

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. In March 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. With Statements No. 63 and 65, GASB has reclassified certain assets and liabilities as "*deferred outflows*" and "*deferred inflows*" of resources. Further, GASB has replaced the term "*net position*" with "*net assets*," and has changed the balance sheet presentation to "*assets, plus deferred outflows of resources equals liabilities, plus deferred inflows of resources, plus net position*." PASSHE is required to adopt Statement No. 63 for the fiscal year ending June 30, 2013, and Statement No. 65 for the fiscal year ending June 30, 2014. PASSHE has determined that the adoption of these GASB Statements will have no effect on the substance of its financial statements but will increase the complexity of the financial statements to its readers, as the new presentation will differ from the traditional and familiar business reporting model.

In June 2012, GASB issued Statement No. 67, *Accounting and Financial Reporting for Pensions*. Statement No. 67 will require PASSHE to report its share of the pension liabilities that the Commonwealth of Pennsylvania State Employees' Retirement System (SERS) and Public School Employees' Retirement System (PSERS) must record beginning in Fiscal Year 2014/15. Although PASSHE has not received an estimate of its share of the pension liabilities from either organization, the liabilities are expected to be significant and have a detrimental effect on its financial statements.

(2) Deposits and Investments

Board *Policy 1986-02-A, Investment*, authorizes PASSHE to invest in obligations of the U.S. Treasury, repurchase agreements, commercial paper, certificates of deposit, banker's acceptances, U.S. money market funds, municipal bonds, corporate bonds, collateralized mortgage obligations (CMOs), asset-backed securities, and internal loan funds. 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 deposits of cash. 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 and in accordance with ethical and prevailing legal standards. Investment decisions are intended to minimize risk while maximizing asset value. Adequate liquidity is maintained so that assets can be held to maturity. 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 may be made in U.S. dollar-denominated debt of high quality U.S. and non-U.S. corporations. Investment performance is monitored on a frequent and regular basis to ensure that objectives are attained and guidelines are followed.

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.

PASSHE's operating funds are invested and reinvested in the following types of instruments with qualifications as provided. (See Board *Policy 1986-02-A, Investment*, for a complete list of and more details on permissible investments and associated qualifications.)

Investment Categories	Qualifications/Moody's Ratings Requirements
United States Government Securities	Together with repurchase agreements must comprise at least 20% of the market value of the fund.
Repurchase Agreements	Underlying collateral must be direct obligations of the United States Treasury and be in PASSHE's or its agent's custody.
Commercial Paper	P-1 and P-2 notes only, with no more than 5% and 3%, respectively, of the market value of the fund invested in any single issuer. Total may not exceed 20% of the market value of the fund.
Municipal Bonds	Bonds must carry long-term debt rating of A or better. Total may not exceed 20% of the market value of the fund.
Corporate Bonds	15% must carry long-term debt rating of A or better; 5% may be rated Baa2 or better. Total may not exceed 20% of the market value of the fund.
Collateralized Mortgage Obligations (CMOs)	Must be rated Aaa and guaranteed by U.S. government. Total may not exceed 20% of the market value of the fund.
Asset-Backed Securities	Must be Aaa rated. Total may not exceed 20% of the market value of the fund, with no more than 5% invested in any single issuer.
System Investment Fund Loans (university loans and bridge notes)	Total may not exceed 20% of the market value of the fund, and loan terms may not exceed 5 years.

CMO Risk: 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.

Moody's Rating: PASSHE uses ratings from Moody's Investors Service, Inc., to indicate the credit risk of investments, i.e., the risk that an issuer or other counterparty to an investment will not fulfill its obligations. An *Aaa* rating indicates the highest quality obligations with minimal credit risk. Ratings that begin with *Aa* indicate high quality obligations subject to very low credit risk; ratings that begin with *A* indicate upper-medium-grade obligations subject to low credit risk; and ratings that begin with *Baa* indicate medium-grade obligations, subject to moderate credit risk, that may possess certain speculative characteristics. Moody's appends the ratings with numerical modifiers *1*, *2*, and *3*, with *1* indicating a higher ranking and *3* indicating a lower ranking within the category. For short-term obligations, a rating of *P-1* indicates that issuers have a superior ability to repay short-term debt obligations, and a rating of P-2 indicates that issuers have a strong ability to repay short-term debt obligations.

Modified Duration: PASSHE denotes interest rate risk, or the risk that changes in interest rates will affect the fair value of an investment, using *modified duration*. *Duration* is a measurement in years of how long it takes for the price of a bond to be repaid by its internal cash flows. *Modified duration* takes into account changing interest rates. PASSHE maintains a portfolio duration target of 1.8 years with an upper limit of 2.5 years for the intermediate-term component of the operating portion of the investment portfolio. PASSHE's duration targets are not applicable to its long-term investments.

On June 30, 2012 and 2011, the carrying amount of PASSHE's demand and time deposits and certificates of deposit for all funds was $23,761,000 and $22,188,000, respectively, compared to bank balances of $22,470,000 and $22,155,000, respectively. The difference is caused primarily by items in transit. Of the bank balances, $3,529,000 and $3,575,000, 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; $2,302,000 and $2,295,000, respectively, were uninsured and uncollateralized; and $16,639,000 and $16,285,000, 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, 2012 and 2011, follow.

PASSHE Pooled Deposits and Investments
June 30, 2012
(in thousands)

	Moody's Rating (if applicable)	**Modified Duration** (if applicable)	**Fair Value**
Deposits			
Money market funds			$3,741
Total deposits			3,741
Investments			
Repurchase agreements			40,872
Commercial paper	P1	0.06	187,893
U.S. government and agency obligations	Aaa	3.15	495,203
Asset-backed securities	Aaa	0.69	69,846
	P1	0.17	41,026
Collateralized mortgage obligations (CMOs)	Aaa	2.01	211,515
Corporate bonds and notes	Aaa	2.58	29,519
	Aa1	1.62	10,684
	Aa2	1.91	31,849
	Aa3	1.89	56,803
	A1	2.23	15,488
	A2	2.34	33,162
	A3	3.92	5,131
	Baa1	2.31	19,192
	Baa2	2.73	28,899
	Baa3	0.14	5,729
Total investments			1,282,811
Total deposits and investments			$1,286,552

PASSHE Pooled Deposits and Investments
June 30, 2011
(in thousands)

	Moody's Rating (if applicable)	**Modified Duration** (if applicable)	**Fair Value**
Deposits			
Demand and time deposits			$100
Money market funds			2,086
Total deposits			2,186
Investments			
Repurchase agreements			7,406
Commercial paper	P1	0.07	312,882
U.S. government and agency obligations	Aaa	4.03	432,705
Asset-backed securities	Aaa	0.77	68,945
	P1	0.19	21,633
Collateralized mortgage obligations (CMOs)	Aaa	3.66	150,660
Corporate bonds and notes	Aaa	2.32	40,390
	Aa1	2.53	10,761
	Aa2	2.53	58,651
	Aa3	2.42	24,492
	A1	1.28	7,023
	A2	1.16	2,998
	Baa1	1.35	7,493
	Baa3	0.96	725
Total investments			1,146,764
Total deposits and investments			$1,148,950

Of the investments noted above at June 30, 2012 and 2011, $36,525,000 and $28,826,000, 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 8). 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 local university deposits and investments on June 30, 2012 and 2011, follow.

University Local Deposits and Investments
June 30, 2012
(in thousands)

	Moody's Rating (if applicable)	**Modified Duration** (if applicable)	**Fair Value**
Deposits			
Demand and time deposits			$19,997
Certificates of deposit			23
Total deposits			20,020
Investments			
U.S. government and agency obligations		1.17	736
Fixed-income mutual funds		4.52	4,747
Equity/balanced mutual funds			26,225
Common stock			1,972
Total investments			33,680
Total deposits and investments			$53,700

University Local Deposits and Investments
June 30, 2011
(in thousands)

	Moody's Rating (if applicable)	**Modified Duration** (if applicable)	**Fair Value**
Deposits			
Demand and time deposits			$19,979
Certificates of deposit			23
Total deposits			20,002
Investments			
U.S. government and agency obligations		1.96	666
Fixed-income mutual funds		3.39	3,950
Equity/balanced mutual funds			25,231
Common stock			1,081
Total investments			30,928
Total deposits and investments			$50,930

Of the local investments noted above, the exposure to foreign currency risk is as follows.

(in thousands)

		Fair Value	
Investment	**Currency**	June 30, 2012	June 30, 2011
Deposit	British Pound	$44	$11
Deposit	Euro	0	1
Total		$44	$12

The universities are beneficiaries of trust funds held by others with an approximate fair value of $3,608,000 and $3,609,000 on June 30, 2012 and 2011, 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 $7,773,000 and $9,229,000 for the years ended June 30, 2012 and 2011, respectively.

Capital assets on June 30, 2012 and 2011, included $75,579,000 and $62,677,000, 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**
2013	$5,220	$11,371
2014	4,235	5,266
2015	3,519	4,904
2016	3,088	4,697
2017	3,003	4,597
Thereafter	37,324	47,160
Total minimum lease payments	$56,389	77,995
Amount representing interest on capital leases		22,475
Present value of net minimum capital lease payments		$55,520

Changes in the liability for capital leases in fiscal years 2012 and 2011 follow.

(in thousands)

Year	**Beginning Balance**	**Capital Lease Additions**	**Capital Lease Payments**	**Ending Balance**
2011	$47,504	$2,282	$3,350	$46,436
2012	$46,436	$13,259	$4,175	$55,520

(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. Contribution rates for most active members are between 5.25% and 7.50% of their qualifying compensation, depending upon when the active member was hired and what benefits class was selected. New members hired after July 1, 2011, have a one-time election to choose a 10.3% contribution rate. The contribution rate for PASSHE is an actuarially determined rate. The rate was 4.325% of annual covered payroll at June 30, 2012. PASSHE's contributions to PSERS for the years ended June 30, 2012, 2011, and 2010, were $1,769,000, $1,481,000, and $948,000, 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. Contribution rates for most active members are between 5.0% and 6.25% of their qualifying compensation. New members hired after January 1, 2011, have a one-time election to choose a 9.3% contribution rate. PASSHE contributed at actuarially determined rates of between 4.83% and 6.99% of active members' annual covered payroll at June 30, 2012. PASSHE's contributions to SERS for the years ended June 30, 2012, 2011, and 2010, were $20,643,000, $13,032,000, and $10,182,000, 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 equal 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, 2012 and 2011, was 9.29% of qualifying compensation. The contributions to the ARP for the years ended June 30, 2012 and 2011, were $41,978,000 and $42,851,000, respectively, from PASSHE; and $23,165,000 and $23,139,000, 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 (APSCUF), the State College and University Professional Association (SCUPA), Security Police and Fire Professionals of America (SPFPA), Pennsylvania Nurses Association (PNA), 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 the 14 PASSHE universities. Act 188 empowers the Board to establish and amend benefits provisions. The System Plan has no plan assets 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 $38,729,000 and $37,245,000 for the fiscal years ending June 30, 2012 and 2011, respectively. Plan members receiving benefits 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. Following are the contribution rates of plan members as of June 30, 2012:

- Plan members receiving benefits who retired prior to July 1, 2005, are not required to make contributions.
- Nonfaculty coaches who retired July 1, 2005, or after pay a percentage of their final annual gross salary at the time of retirement.
- Other eligible annuitants who retired on or after July 1, 2005, and prior to January 1, 2008, and who are under age 65 pay 10% of the plan premium in effect on the day of retirement. When annuitants become eligible for Medicare, they pay 15% of the current cost of their Medicare coverage and current cost of coverage for covered dependents. The rate changes annually.

- Other eligible annuitants who retire after July 1, 2009, pay 15% of the plan premium in effect when they retired.

Total contributions made by plan members were $3,189,000 and $2,762,000, or approximately 7.6% and 6.9% of the total premiums, for the fiscal years ending June 30, 2012 and 2011, respectively.

Annual OPEB Cost and Net OPEB Obligation

PASSHE's annual other postemployment benefit (OPEB) cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with GASB Statement No. 45. The ARC represents a level of funding that, if paid annually, is projected to cover normal cost plus the annual portion of the unfunded actuarial liability amortized over 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	$116,548
Interest on net OPEB obligation	35,615
Adjustment to annual required contribution	(40,491)
Annual OPEB cost (expense)	111,672
Contributions made	(38,729)
Increase in net OPEB obligation	72,943
Net OPEB obligation at July 1, 2011	791,452
Net OPEB obligation at June 30, 2012	$864,395

PASSHE's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for June 30, 2012, 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, 2011	$106,123	35.1%	$791,452
June 30, 2012	$111,672	34.7%	$864,395

Funded Status and Funding Progress

The funded status of the plan as of July 1, 2011, the most recent actuarial valuation date, was as follows.

(in thousands)	
Actuarial accrued liability (AAL)	$1,373,049
Actuarial value of plan assets	0
Unfunded actuarial accrued liability (UAAL)	$1,373,049
Funded ratio (actuarial value of plan assets/AAL)	0%
Covered payroll (active plan members)	$570,839
UAAL as a percentage of covered payroll	241%

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, 2011, actuarial valuation (revised November 2011), the projected unit credit method was used. The actuarial assumptions included a 4.5% 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 5.0% by 2025. The UAAL is being amortized as a level percentage of payroll on a closed basis. The remaining amortization period at July 1, 2011, was 24 years.

Retired Employees Health Program

Plan Description

Employee members of the American Federation of State, County and Municipal Employees (AFSCME); Pennsylvania Doctors Alliance (PDA); and Pennsylvania Social Services Union (PSSU) 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 Fiscal Year 2011/12, PASSHE contributed $240 for each current active employee per biweekly pay period. PASSHE made contributions of $23,228,000, $20,069,000, and $25,318,000 for the fiscal years ending June 30, 2012, 2011, and 2010, respectively, equal to 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 must pay up to $100,000; for claims occurring on or after July 1, 1995, PASSHE universities must pay up to $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 $2,004,000 and $1,365,000 to the Reserve Fund during the years ended June 30, 2012 and 2011, respectively.

For the years ended June 30, 2012 and 2011, the aggregate liability for claims under the self-insurance limit was $10,243,000 and $10,852,000, respectively. The Reserve Fund assets of $9,520,000 and $8,134,000 are equal to the liability for claims in excess of the self-insurance limits for the years ended June 30, 2012 and 2011, respectively. Changes in the workers' compensation claims liability in fiscal years 2012 and 2011 follow.

(in thousands)

Year	Beginning Balance	Current Year Claims and Changes in Estimates	Claim Payments	Ending Balance
2011	$16,484	$6,791	$4,290	$18,985
2012	$18,985	$5,888	$5,110	$19,763

(7) Compensated Absences

Changes in the compensated absences liability in fiscal years 2012 and 2011 are as follows.

(in thousands)

Year	Beginning Balance	Current Changes in Estimates	Less Payouts	Ending Balance
2011	$104,042	$9,812	$12,026	$101,828
2012	$101,828	$14,837	$8,459	$108,206

(8) Bonds Payable

Bonds payable on June 30, 2012 and 2011, 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, 2012 and 2011, was as follows.

Bonds Payable
June 30, 2012 and 2011
(in thousands)

Description	Original Issuance	Weighted Average Interest Rate	Balance June 30, 2010	2011 Bonds Issued	2011 Bonds Redeemed/ Refunded	Balance June 30, 2011	2012 Bonds Issued	2012 Bonds Redeemed/ Refunded	Balance June 30, 2012	Current Portion
Series T issued July 2001, final maturity June 2021	$69,555	4.86%	$33,785	-	$33,785	-	-	-	-	-
Series U issued August 2002, final maturity June 2022	14,400	4.43%	8,780	-	690	$8,090	-	$8,090	-	-
Series W issued October 2002, final maturity June 2020	69,105	4.76%	61,795	-	865	60,930	-	60,930	-	-
Series X issued May 2003, final maturity June 2023	80,910	4.28%	36,320	-	4,850	31,470	-	31,470	-	-
Series Z issued March 2004, final maturity June 2024	71,760	3.95%	47,735	-	4,630	43,105	-	1,875	$41,230	$1,930
Series AA issued July 2004, final maturity June 2024	28,750	4.62%	20,595	-	1,540	19,055	-	1,605	17,450	1,665
Series AC issued July 2005, final maturity June 2025	52,650	4.90%	41,545	-	2,425	39,120	-	2,540	36,580	2,675
Series AE issued July 2006, final maturity June 2036	103,290	4.99%	90,795	-	3,480	87,315	-	3,645	83,670	3,835
Series AF issued July 2007, final maturity June 2037	68,230	4.95%	62,780	-	1,935	60,845	-	2,020	58,825	2,105
Series AG issued March 2008, final maturity June 2024	101,335	4.60%	90,830	-	4,390	86,440	-	4,540	81,900	4,395
Series AH issued July 2008, final maturity June 2038	140,760	4.69%	134,360	-	3,860	130,500	-	3,645	126,855	3,830
Series AI issued August 2008, final maturity June 2025	32,115	4.01%	28,780	-	1,880	26,900	-	1,665	25,235	1,725
Series AJ issued July 2009, final maturity June 2039	123,985	4.90%	121,160	-	3,415	117,745	-	3,720	114,025	4,225
Series AK issued Sept. 2009, final maturity June 2024	47,310	3.66%	46,090	-	3,080	43,010	-	3,485	39,525	3,580
Series AL issued July 2010, final maturity June 2035	135,410	5.00%	-	$135,410	4,645	130,765	-	7,180	123,585	7,705
Series AM issued July 2011, final maturity June 2036	119,085	4.62%	-	-	-	-	$119,085	3,060	116,025	3,865
Series AN issued March 2012, final maturity June 2023	76,840	4.78%	-	-	-	-	76,810	-	76,810	375
Total	**$1,335,490**	**-**	**$825,350**	**$135,410**	**$75,470**	**$885,290**	**$195,895**	**$139,470**	**$941,715**	**$41,910**

Principal and interest requirements to maturity are as follows.

(in thousands)	Principal	Interest	Total
2013	$41,910	$45,499	$87,409
2014	46,970	42,801	89,771
2015	54,970	40,689	95,659
2016	60,825	38,069	98,894
2017	61,910	35,105	97,015
2018–2022	307,840	129,921	437,761
2023–2027	213,460	63,070	276,530
2028–2032	105,610	25,190	130,800
2033–2037	46,410	5,890	52,300
2038–2039	1,810	101	1,911
Total	**$941,715**	**$426,335**	**$1,368,050**

(9) Debt Refundings

In March 2012, the net proceeds from the Series AN revenue bonds was used to current refund the Series U, W, and X bonds. This refunding was performed to reduce debt service by approximately $13,778,000 and resulted in an economic gain (difference between the present values of the old and new debt service payments) of approximately $13,318,000.

(10) Capital Assets

The classifications of capital assets and related depreciation at June 30, 2012 and 2011, follow.

(in thousands)	Balance June 30, 2010	2010/11 Additions	2010/11 Retirements/ Adjustments	Balance June 30, 2011	2011/12 Additions	2011/12 Retirements/ Adjustments	Balance June 30, 2012
Land	$24,770	$876	$658	$26,304	$987	$315	$27,606
Construction in progress	159,881	111,842	(96,445)	175,278	75,983	(158,634)	92,627
Total capital assets not being depreciated	184,651	112,718	(95,787)	201,582	76,970	(158,319)	120,233
Buildings, including improvements	1,553,171	57,913	76,696	1,687,780	73,283	127,859	1,888,922
Improvements other than buildings	211,245	2,895	9,691	223,831	3,374	5,021	232,226
Equipment and furnishings	366,450	20,843	909	388,202	32,028	4,810	425,040
Library books	83,848	1,784	(1,822)	83,810	1,342	(1,192)	83,960
Total capital assets being depreciated	2,214,714	83,435	85,474	2,383,623	110,027	136,498	2,630,148
Less accumulated depreciation							
Buildings and improvements	(502,052)	(66,642)	368	(568,326)	(71,357)	2,531	(637,152)
Land improvements	(86,335)	(8,943)	(38)	(95,316)	(9,090)	886	(103,520)
Equipment and furnishings	(275,534)	(30,083)	7,337	(298,280)	(30,292)	14,837	(313,735)
Library books	(70,644)	(2,503)	1,802	(71,345)	(2,415)	1,173	(72,587)
Total accumulated depreciation	(934,565)	(108,171)	9,469	(1,033,267)	(113,154)	19,427	(1,126,994)
Total capital assets being depreciated, net	1,280,149	(24,736)	94,943	1,350,356	(3,127)	155,925	1,503,154
Capital assets, net	$1,464,800	$87,982	($844)	$1,551,938	$73,843	($2,394)	$1,623,387

(11) Contingencies, Commitments, and Concentrations

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.

Construction Commitments

Authorized expenditures for construction projects unexpended as of June 30, 2012 and 2011, were approximately \$100,049,000 and \$118,168,000, respectively.

Labor Concentration

Approximately 88% of PASSHE's labor force is covered by collective bargaining agreements. The contract for APSCUF, which represents PASSHE's faculty and coaches, or approximately 46% of the labor force, expired June 30, 2011. The contract for SCUPA, which represents approximately 5% of PASSHE's labor force and includes professional employees working in areas such as admissions, financial aid, and residence life, also expired June 30, 2011. Negotiations between PASSHE and these unions are ongoing.

(12) Subsequent Events

In July 2012, Moody's placed PASSHE's Aa2 bond rating on review for downgrade as a result of the Commonwealth's rating downgrade from Aa1 to Aa2. The results of the review should be known later in the fall of 2012.

REQUIRED SUPPLEMENTARY INFORMATION

Years Ended June 30, 2012 and 2011

(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, 2009	$0	$1,127,437	$1,127,437	0%	$525,684	214%
July 1, 2010	$0	$1,315,116	$1,315,116	0%	$554,213	237%
July 1, 2011	$0	$1,373,049	$1,373,049	0%	$570,839	241%

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, 2009	$47,920	$13,257,570	$13,209,650	.36%	$4,093,000	323%
July 1, 2010	$56,320	$13,674,250	$13,617,930	.41%	$3,786,000	360%
July 1, 2011	$70,740	$12,907,790	$12,837,050	.55%	$3,839,000	334%

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