FINANCIAL STATEMENTS
JUNE 30, 2013

UNIVERSITIES OF THE PENNSYLVANIA STATE SYSTEM OF HIGHER EDUCATION

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CliftonLarsonAllen LLP
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INDEPENDENT AUDITORS' REPORT

Board of Governors
Pennsylvania State System of Higher Education
Harrisburg, Pennsylvania

Report on the Financial Statements

We have audited the accompanying financial statements of the business type activities and the aggregate discretely presented component units of the Pennsylvania State System of Higher Education ("PASSHE"), a component unit of the Commonwealth of Pennsylvania, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise PASSHE's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of the discretely presented component units, which represent 100% percent, 100% percent, and 100% percent, respectively, of the assets, net assets, and revenues of the discretely presented component units. Those 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 discretely presented component units, is based solely on the reports of the other auditors. We conducted our audit 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 from material misstatement.

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

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

Opinion

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the business type activities and the aggregate discretely presented component units of PASSHE as of June 30, 2013, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3-11 and the required supplementary information on page 34 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.

Other Information

The financial statements of PASSHE as of June 30, 2012, were audited by other auditors whose report dated September 26, 2012, expressed an unmodified opinion on those statements.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Harrisburg, Pennsylvania
September 26, 2013

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 over 114,000 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, 2013, as compared to the year ended June 30, 2012.

FINANCIAL HIGHLIGHTS

- In fiscal year 2012/13, PASSHE received $412.8 million in General Fund **appropriations** from the Commonwealth, the same amount as received in fiscal year 2011/12. This is 11.3% less than the General Fund appropriations received in fiscal year 2010/11 and the same level of funding PASSHE received in fiscal year 1997/98—fifteen years ago.

- PASSHE received an $11.7 million Realty Transfer Tax allocation from the Commonwealth's **Key '93** (Keystone Recreation, Park and Conservation) Fund, an increase of $4.9 million, or 71%, from fiscal year 2011/12. With the exception of fiscal years 2010/11 and 2009/10, when no funding was provided, Key '93 funds have provided a consistent revenue stream for university deferred maintenance projects since 1993.

- PASSHE received $65 million in **Commonwealth capital funding**, primarily for renovation or replacement of existing educational and general buildings. With the exception of fiscal years 2010/11 and 2009/10, when the Commonwealth's capital funding for PASSHE was $130 million each year, PASSHE has received $65 million annually in Commonwealth capital funding since fiscal year 2000/01. Annual funding is expected to remain at $65 million for the foreseeable future. The portion of capital appropriations reflected in these statements, representing the furnishings and equipment for the Commonwealth-funded construction projects, totals $14.8 million and $9.7 million in fiscal years 2012/13 and 2011/12, 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 $36.6 million of PASSHE's appropriations for **performance funding** in fiscal year 2012/13, approximately 2% more than the $35.9 million allocated in fiscal year 2011/12. Performance funding allocated in fiscal year 2010/11 was $35.6 million.

- After 14 years of record growth, PASSHE has experienced an **enrollment decline** in fiscal year 2012/13 for the second year in a row. Fall 2012 enrollment was 114,471, a decrease of 3,753 students, or 3.2%, from fall 2011. Fall 2011 enrollment was 118,224, a decrease of 1,289 students, or 1.1%, from the fall 2010 record enrollment of 119,513. Despite these two years of decline, PASSHE's fall enrollment has increased 40% since fall of 1983, which was PASSHE's first year of operation as a System.

- Of the 114,471 **students** in the fall 2012 enrollment, 97,823 (85%) were full-time and 16,648 (15%) were part-time students; 100,350 (88%) were undergraduate and 14,121 (12%) were graduate students.

- In academic year 2011/12, PASSHE awarded 25,560 **degrees**, comprising 19,439 bachelor's degrees; 5,467 master's degrees; 206 doctoral degrees; and 448 associate's degrees. This compares to 24,672 degrees awarded in academic year 2010/11 and 24,168 degrees awarded in academic year 2009/10.

- The Board approved a **tuition rate increase** of $188 (3%) for undergraduate resident students in fiscal year 2012/13. This compares to an increase of $436 (7.5%) in fiscal year 2011/12, primarily due to the reduction in state appropriations. PASSHE's 2012/13 annual tuition rate of $6,428 for full-time, resident, undergraduate students is the lowest of four-year baccalaureate degree programs in the state.

- **Mandatory student fees** set by the universities increased, on average, by 3.8%. These increases, combined with the reduction in enrollment, resulted in tuition and mandatory fee revenue (before discounts) of $1.02 billion, a slight increase over fiscal year 2011/12. This compares to an average student fee increase of 9.4% in fiscal year 2011/12 over the prior year.

- The most common **room and board fees** (included in auxiliary enterprises) set by the universities increased 4.8% and 1.1%, respectively, resulting in revenue of $266.5 million, an increase of $19.6 million, or 7.9%, over fiscal year 2011/12. This compares to a fiscal year 2011/12 increase of 4.7% in room fees and 1.4% in board fees over the prior fiscal year.

- PASSHE's **average cost of attendance** (tuition, mandatory fees, room, and board) of $17,051 in 2012/13 was $809 below the average among all four-year public universities in the United States and $2,503 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 $139.3 million in **capital assets** in fiscal year 2012/13, including $106.8 million to build or improve academic and auxiliary facilities across all 14 universities.

- During fiscal year 2012/13, $41.9 million of bond principal and $45.5 million of interest was paid, bringing the total outstanding **bond debt** to $899.8 million at June 30, 2013. PASSHE issued no new bonds in fiscal year 2012/13.

The Financial Statements

The *Balance Sheet* reports the balances of the assets, liabilities, and net position of PASSHE as of the end of the fiscal year. (**The term "net position" was formerly referred to as "net assets."** The Governmental Accounting Standards Board, or GASB, changed the terminology to net position effective for the year ending June 30, 2013.) 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 position**.

The *Statement of Revenues, Expenses, and Changes in Net Position* reports the revenues earned and the expenses incurred during the fiscal year. The result is reported as an increase or decrease in net position. In accordance with 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, Pell grants, 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 Position

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

- *Net investment in capital assets (formerly referred to as 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 position represents the portion of 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 position represents corpuses of endowments and similar arrangements in which only the associated investment income can be spent. *Expendable* restricted net position represents the portion of restricted funds that is available for expenditure as long as any external purpose and time restrictions are met.

- *Unrestricted* net position includes 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 position reflects two unfunded liabilities:

- o The liability for **postretirement benefits** for employees who participate in the PASSHE plan increased by $69.3 million to $933.7 million for the year ended June 30, 2013. 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.

- o The liability for **compensated absences** increased by $1.7 million to $109.9 million for the year ended June 30, 2013. 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 position decreased by $14.8 million in fiscal year 2012/13, compared to an increase of $71.6 million in fiscal year 2011/12.

Following is a summary of the balance sheet at June 30, 2013, 2012, and 2011.

(in millions)

Balance Sheet

	June 30, 2013	Change from Prior Year	June 30, 2012	Change from Prior Year	June 30, 2011	Change from Prior Year
Assets						
Cash and investments	$1,362.8	1.7%	$1,340.3	11.7%	$1,199.9	6.5%
Capital assets, net	1,629.6	0.4%	1,623.4	4.6%	1,551.9	5.9%
Other assets	170.3	(11.9%)	193.4	(7.6%)	209.4	17.8%
Total assets	$3,162.7	0.2%	$3,157.1	6.6%	$2,961.2	6.9%
Liabilities						
Workers' compensation	$21.3	7.6%	$19.8	4.2%	$19.0	15.2%
Compensated absences	109.9	1.6%	108.2	6.3%	101.8	(2.1%)
Postretirement benefits	933.7	8.0%	864.4	9.2%	791.5	9.5%
Bonds payable	899.8	(4.4%)	941.7	6.4%	885.3	7.3%
Other liabilities	400.1	(2.5%)	410.3	(2.9%)	422.5	2.3%
Total liabilities	2,364.8	0.9%	2,344.4	5.6%	2,220.1	6.7%
Net Position						
Net investment in capital assets	653.7	5.2%	621.4	3.3%	601.6	(2.3%)
Restricted	92.5	7.3%	86.2	12.7%	76.5	12.7%
Unrestricted	51.7	(50.8%)	105.1	66.8%	63.0	1,752.9%
Total net position	797.9	(1.8%)	812.7	9.7%	741.1	7.8%
Total liabilities and net position	$3,162.7	0.2%	$3,157.1	6.6%	$2,961.2	6.9%

Revenues and Expenses
Overall, fiscal year 2012/13 **operating revenues** decreased slightly by .4% from the prior fiscal year. Nonoperating revenues decreased 2.1%.

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 2012/13 was $20.8 million. This represents a decrease of $4.1 million from the prior year, despite an increase in PASSHE's average monthly operating capital of approximately $114 million from the prior year. The decrease in investment income is due to the continuing decline in interest rates. Interest rates decreased over the fiscal year from a high of 1.34% in July 2012 to a low of 0.90% in March 2013, or a 61-basis-point decrease from the prior fiscal year high. The 12-month average interest rate for fiscal year 2012/13 was 22 basis points lower than the average 12-month interest rate for fiscal year 2011/12.

- Universities spent $704.5 million on **instruction**, or 36.6% of total operating expenses, in fiscal year 2012/13. This represents an increase of $21.1 million, or 3.1%, over fiscal year 2011/12.

- **Financial aid** to students in the form of waivers and scholarships was $286.9 million in fiscal year 2012/13, a decrease of $14.7 million from the previous year. In accordance with a formula prescribed by the National Association of College and University Business Officers (NACUBO), PASSHE reported $211.2 million of financial aid as *scholarship discounts and allowances* (netted against tuition and fees) and $74.5 million as *student aid* expense in fiscal year 2012/13. $1.2 million of financial aid was reported in Auxiliary enterprises. Following is the breakdown of scholarship discounts and allowances and waivers in fiscal years 2012/13 and 2011/12:

(in millions)

Student Financial Aid

	2012/13	2011/12
Federal Pell grants	$140.6	$145.7
Other federal aid	6.8	6.2
State financial aid including PHEAA	89.6	104.0
Local government financial aid	1.7	1.7
Scholarships from endowments and restricted gifts and grants	13.0	10.3
Unrestricted scholarships and fellowships	12.3	12.0
Tuition and fee waivers	21.6	20.6
Dorm and dining waivers	1.3	1.1
Total	$286.9	$301.6

- **Interest expense** on capital asset-related debt was $38.8 million, a decrease of $2.8 million over fiscal year 2011/12.

- According to the Pennsylvania Department of Labor and Industry, PASSHE is the 14th largest employer in the state, with more than 13,000 employees. **Salaries and benefits** totaled $1.3 billion in fiscal year 2012/13. Compared to fiscal year 2011/12, salary and wage expenses increased by $15.5 million, or 1.8%, while benefit expenses increased by $19.8 million, or 4.9%, for an overall increase of $35.3 million:

  - Employer share of **employee health care** costs increased 2.9% over fiscal year 2011/12, for a total increase of $3.3 million. This follows consecutive decreases of 6.1% ($7.4 million) and 1.5% ($1.8 million) in fiscal years 2011/12 and 2010/11, respectively, over the prior fiscal years.

  - Employer **annuitant health care** costs increased 2.2% over fiscal year 2011/12, for a total increase of $3.0 million. This follows consecutive increases of 6.9% ($8.7 million) and 7.8% ($9.1 million) in fiscal years 2011/12 and 2010/11, 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 retirees.

- Employer contributions to **SERS** (Commonwealth of Pennsylvania State Employees' Retirement System), which is a defined benefits pension plan, increased 48.1% over fiscal year 2011/12, for a total increase of $9.9 million. This follows consecutive increases of 58.5% ($7.6 million) and 28.0% ($2.8 million) in fiscal years 2011/12 and 2010/11, respectively, over the prior fiscal years. The steep increases were instituted by SERS to fund its enormous and growing unfunded actuarial accrued liability, which was $17.8 billion at December 31, 2012, up from $14.7 billion at December 31, 2011. Approximately 40% of PASSHE's employees are enrolled in SERS.

- Employer contributions to **PSERS** (Public School Employees' Retirement System), which is a defined benefits pension plan, increased 55.6% over fiscal year 2011/12, for a total increase of $1.0 million. This follows consecutive increases of 20.0% ($0.3 million) and 56.3% ($0.5 million) in fiscal years 2011/12 and 2010/11, respectively, over the prior fiscal years. The steep increases were instituted by PSERS to fund its enormous and growing unfunded actuarial accrued liability, which was $26.5 billion at June 30, 2012, up from $19.7 billion at June 30, 2011. Since only approximately 7% of PASSHE's employees are enrolled in PSERS, the impact of contribution rate increases is far less than the impact from SERS.

- Employer contributions to the **ARP** (Alternate Retirement Plan), which is a defined contribution plan, increased 2.6% over fiscal year 2011/12, for a total increase of $1.1 million. This follows a decrease of 2.1% ($0.9 million) and an increase of 3.8% ($1.6 million) in fiscal years 2011/12 and 2010/11, respectively, over the prior fiscal years. The changes in annual contributions are attributed to fluctuating employee participation. The employer contribution rate (9.29%) has been the same since the plan's inception. Since the ARP is a defined contribution plan, PASSHE has no liabilities related to future benefits. Approximately 49% of PASSHE's employees are enrolled in the ARP.

- The total cost for **all other employee benefits**, such as Social Security and workers' compensation, increased by a total of $1.5 million, or 1.6% more than fiscal year 2011/12, compared to a decrease of $2.3 million in fiscal year 2011/12, or 2.4%, over fiscal year 2010/11.

Following are summaries of salaries, wages, and benefits expenses for the years ending June 30, 2013, 2012, and 2011.

(in millions)

Salaries, Wages, and Benefits

	June 30, 2013	Change from Prior Year	June 30, 2012	Change from Prior Year	June 30, 2011	Change from Prior Year
Salaries and wages	$869.4	1.8%	$853.9	(2.7%)	$877.7	1.8%
Benefits						
Hospitalization	108.6	3.6%	104.8	(6.9%)	112.6	(1.4%)
Health & Welfare Fund	8.3	(5.7%)	8.8	4.8%	8.4	(2.0%)
Annuitant Hospitalization	137.9	2.2%	134.9	6.9%	126.2	7.8%
SERS	30.5	48.1%	20.6	58.5%	13.0	28.0%
PSERS	2.8	55.6%	1.8	20.0%	1.5	56.3%
Alternative Retirement Plan (ARP)	43.1	2.6%	42.0	(2.1%)	42.9	3.8%
Other benefits	96.8	1.6%	95.3	(2.4%)	97.6	3.5%
Total benefits	428.0	4.9%	408.2	1.5%	402.2	4.0%
Total salaries, wages, and benefits	$1,297.4	2.8%	$1,262.1	(1.4%)	$1,279.9	2.5%

Following are summaries of revenues and expenses for the years ending June 30, 2013, 2012, and 2011.

(in millions)

Revenues and Gains

	June 30, 2013	Change from Prior Year	June 30, 2012	Change from Prior Year	June 30, 2011	Change from Prior Year
Operating revenues						
Tuition and fees, net	$804.2	2.3%	$786.4	8.7%	$723.5	8.4%
Grants and contracts	157.9	(9.8%)	175.0	5.2%	166.3	(3.7%)
Auxiliary enterprises, net	332.9	1.8%	327.1	2.5%	319.0	8.4%
Other	44.5	(21.5%)	56.7	38.6%	40.9	9.7%
Total operating revenues	1,339.5	(0.4%)	1,345.2	7.6%	1,249.7	6.7%
Nonoperating revenues and gains						
State appropriations	427.6	1.2%	422.5	(16.3%)	504.7	(5.3%)
Investment income, net	20.4	(16.7%)	24.5	2.1%	24.0	(14.0%)
Unrealized gain on investment	-	(100.0%)	11.7	91.8%	6.1	(61.6%)
Gifts, nonoperating grants, and other	171.8	(1.5%)	174.4	(2.1%)	178.2	15.0%
Total nonoperating revenues and gains	619.8	(2.1%)	633.1	(11.2%)	713.0	(2.5%)
Total revenues and gains	$1,959.3	(1.0%)	$1,978.3	0.8%	$1,962.7	3.1%

(in millions)

Expenses and Losses

	June 30, 2013	Change from Prior Year	June 30, 2012	Change from Prior Year	June 30, 2011	Change from Prior Year
Operating expenses						
Instruction	$704.5	3.1%	$683.4	(1.9%)	$696.7	4.9%
Research	5.4	(18.2%)	6.6	(7.0%)	7.1	0.0%
Public service	34.2	1.2%	33.8	(5.1%)	35.6	(2.2%)
Academic support	170.8	7.5%	158.9	(0.1%)	159.0	(3.5%)
Student services	170.3	2.4%	166.3	1.0%	164.6	6.1%
Institutional support	258.1	2.7%	251.4	0.7%	249.6	1.4%
Operations and maintenance of plant	143.2	4.4%	137.1	(2.3%)	140.3	0.1%
Depreciation	119.5	5.6%	113.2	4.6%	108.2	2.4%
Student aid	74.5	(2.7%)	76.6	(3.8%)	79.6	3.5%
Auxiliary enterprises	243.3	3.3%	235.5	1.9%	231.1	5.0%
Total operating expenses	1,923.8	3.3%	1,862.8	(0.5%)	1,871.8	3.0%
Other expenses and losses						
Interest expense on capital asset-related debt	38.8	(6.7%)	41.6	14.3%	36.4	4.0%
Loss on disposal of assets	6.3	173.9%	2.3	283.3%	.6	(91.8%)
Unrealized gain (loss) on investment	5.1	-	-	-	-	-
Total other expenses and losses	50.2	14.4%	43.9	18.6%	37.0	(12.5%)
Total expenses and losses	$1,974.0	3.5%	$1,906.7	(0.1%)	$1,908.8	2.7%

FUTURE ECONOMIC FACTORS

- The **Commonwealth** ended fiscal year 2012/13 with General Fund collections that were $56.9 million, or 0.2%, more than estimated. The Governor's Program Policy Guidelines for preparation of the 2014/15 Commonwealth budget states that "the Pennsylvania economy is growing very modestly and a number of factors are restraining its growth. The commonwealth budget, which is highly dependent on a growing economy, faces additional challenges, such as increased pension obligations, wage and benefit increases, debt service and medical and entitlement costs. These mandated cost drivers will consume virtually all revenue growth. Therefore, agencies should not assume funding increases for the 2014-15 fiscal year."

- In fiscal year 2013/14, PASSHE will receive $412.8 million in **General Fund appropriations**, the same as received in fiscal years 2012/13 and 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 has received $13.6 million from this revenue stream in fiscal year 2013/14, a 16.2% increase from the $11.7 million received in fiscal year 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 $194 (3.0%) **increase in tuition** for the 2013/14 academic year. This sets the new rate for full-time, resident, undergraduate students at $6,622, the lowest among all four-year colleges and universities in Pennsylvania.

- With an undergraduate population made up of almost 90% Pennsylvania residents—and the majority of those being traditional-age students enrolling right out of high school—PASSHE's enrollment historically has been closely tied to the state's demographic trends. Based on estimates from the National Center for Education Statistics, there were about 2,200 fewer **high school graduates** in Pennsylvania in spring 2012 than in spring 2011, a drop of about 2%. This continuing downward trend, which is especially pronounced in western Pennsylvania, is expected to continue for the next three years before leveling off.

- PASSHE universities are retooling to meet changing student demographics, new program content needs, and the rapid evolution of how, where, when, and by whom courses and programs are offered. PASSHE is proactively responding by **realigning programs and resources**. PASSHE is committed to ensuring relevance in programs, reducing costs through collaboration, and focusing resources on what students want and what the Commonwealth needs.

  - More students now are enrolling in new and existing programs in science, technology, mathematics, business and finance, and allied health than are enrolling in education and other public service programs, which were PASSHE's historic strengths. PASSHE continues to **align academic offerings** with work force needs and student expectations. Over the past five years, the Board created 56 new academic programs, placed 158 programs in moratorium, discontinued 40 programs, and reorganized 90 programs.

  - Universities are realigning faculty and staff resources, as evidenced through **work force reductions** via attrition and layoffs and the reassignment of vacancies to higher priority positions. Through a combination of retirements, voluntary separations, and furloughs, PASSHE had 600 fewer permanent positions in fall 2012 than in fall 2009, a trend that is continuing.

  - PASSHE's **strategic emphasis** adds value as the universities work together to attract, educate, and graduate students via greater collaboration across institutions. For example, new this fall is a multiuniversity electronic admissions application that showcases PASSHE's program offerings, assists prospective students in applying to multiple PASSHE universities, and should result in increased admissions applications. Pathways for entry for nontraditional and returning adult students include articulation agreements in 25 areas of study with Pennsylvania's 14 community colleges, and efforts are underway to assist these students in developing "prior learning portfolios" for college credit in conjunction with the Center for Adult and Experiential Learning.

- In fiscal year 2012/13, SERS (State Employees' Retirement System) continued its steep increases in employer **pension contribution rates** that are anticipated to persist through fiscal year 2014/15 and remain high for the foreseeable future. The most predominant employer-paid SERS rates for PASSHE employees rose 44% in 2013/14, and are anticipated to increase 30% in 2014/15. A similar pattern is occurring with PSERS (Public School Employees' Retirement System). The contribution rate for the ARP (Alternative Retirement Plan) remains unchanged.

- In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. Statement 68 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 funding 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.

  SERS
  - At December 31, 2012, SERS' actuarial accrued pension liability of $43.1 billion was only 58.8% funded, down from 65.3% funded at December 31, 2011, and 75.2% funded the previous year.
  - The actuarial value of SERS' assets was $25.3 billion at December 31, 2012, compared to $27.6 billion at December 31, 2011, and $29.4 billion the previous year.
  - $17.8 billion of the SERS' actuarial pension liability was unfunded at December 31, 2012, compared to $14.7 billion unfunded at December 31, 2011, and $9.7 billion the previous year. This is debt already incurred by the Commonwealth, and it is an obligation that cannot be eliminated by reducing future benefits. SERS predicts that it may take as many as 40 years to fully fund its liability.
  - Employer contributions to SERS in 2012 were only 53.9% of the actuarially calculated Annual Required Contribution, up from 42.8% and 31.4% in 2011 and 2010, respectively.
  - The number of new retirees added to the SERS' rolls in 2012 (5,572) was 45% higher than those removed from the rolls (3,853), increasing the annual allowance paid to retirees to $2.3 billion, or 3.9% higher than 2011.
  - On a positive note, in 2012 the SERS fund earned 12%, well exceeding the assumed rate of 7.5%.
  - At December 31, 2012, PASSHE's employees represented 4.8% of active SERS members.

  PSERS
  - At June 30, 2012, PSERS' actuarial accrued pension liability of $85.6 billion was only 69.1% funded, down from 75.1% funded at June 30, 2011, and 79.2% funded the previous year.
  - The actuarial value of PSERS' assets was $59.1 billion at June 30, 2012, compared to $59.3 billion at June 30, 2011, and $59.8 billion the previous year.
  - $26.5 billion of the PSERS' actuarial pension liability was unfunded at June 30, 2012, compared to $19.7 billion unfunded at June 30, 2011, and $15.7 billion the previous year. This is debt already incurred and cannot be eliminated by reducing future benefits.
  - The 2012 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.

- **Moody's Rating and Outlook**
  In October 2012, after downgrading the Commonwealth's rating from Aa1 *negative* to Aa2 *stable*, Moody's Investors Service, Inc. (Moody's), downgraded PASSHE's **bond rating from Aa2 to Aa3**. Moody's ratings outlook for PASSHE is *stable*. In June 2013, Moody's *Outlook* for PASSHE was as follows:

  What could make the rating go up (not for the foreseeable future given the downgrade):
  - Substantial decline in the OPEB liability from benefits restructuring.
  - Consistently favorable operating performance and strong cash flow generation.
  - Increased student demand with higher nonresident student enrollment.

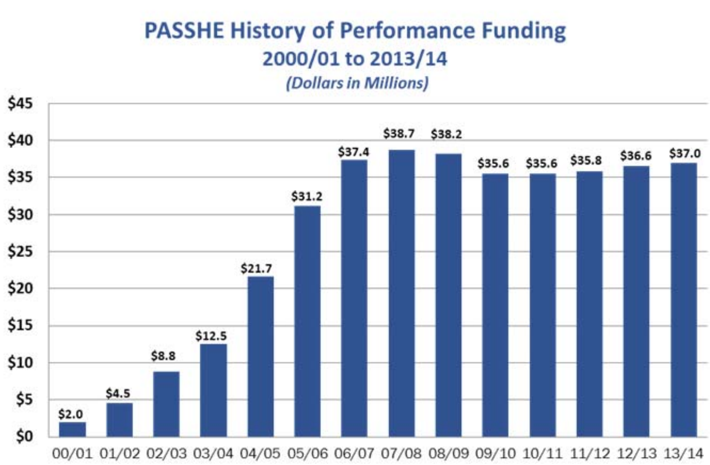
  What could make the rating go down:
  - Stagnant or declining tuition revenues from continued enrollment declines or downward pressures on tuition increases.
  - Failure to respond to enrollment declines.
  - The rising OPEB and pension costs.
  - Failure to achieve significant gains in union contract negotiations.
  - Substantially reduced state funding.
  - Downgrade in the rating of the Commonwealth.
  - Further increase in debt, including student housing, without growth in financial resources.

- **Performance Funding**
  Calls for increased accountability among colleges and universities have come from various sources across the nation. One of the more recent examples is a recommendation by Governor Tom Corbett's ***Advisory Commission on Postsecondary Education*** to link any new funding for higher education

institutions to performance expectations. PASSHE has more than a decade of experience in this area, having introduced performance funding in 2000/01 and having grown it into a national model. PASSHE continues to be one of the few public university systems in the nation to voluntarily implement this type of performance program. Many of the measures PASSHE uses closely align with the general goals for performance-based funding that were included in the report of the Governor's advisory commission, which was issued in fall of 2012. They include:

- The number of degrees conferred, especially in high-need areas such as science, technology, engineering, and mathematics (STEM) and health care.
- Student persistence rates into their third and fourth academic years.
- Closing the achievement and access gaps of Pell grant recipients and underrepresented minorities.
- Student and employee diversity.
- Investment in facilities.
- Private funds raised.

PASSHE universities have "earned" nearly **$340 million** through performance since this program was instituted. This initiative has resulted in increased graduation and retention rates, especially among underrepresented student groups; greater diversity among both the student population and all employee groups—executives, faculty, and professional staff; and higher fundraising results for the universities despite a still sluggish economy.



PASSHE is committed to funding its performance program at a level equal to 2.4% of the Educational and General (E&G) budget. The Board allocated **$36.98 million** in performance funding for fiscal year 2013/14, an increase of $0.4 million over fiscal year 2012/13.

- Construction of **PennREN** (Pennsylvania Research and Education Network), a 1,600-mile high-speed fiber-optic network across the Commonwealth, was completed in February 2013. PennREN provides network connectivity between both public and private higher education institutions, provides opportunities for partnerships with K-12 schools, increases access to national and federal research centers to enhance student learning, and promotes the use of telemedicine and use of electronic medical records. As the Keystone Initiative for Network Based Education and Research (KINBER) continues to grow in membership, opportunities for education collaboration, information sharing, and economic development will be realized.

- On July 1, 2013, at the direction of the Board of Governors' Audit Committee, PASSHE implemented an **Incident Reporting System** to collect and record both anonymous and self-identified complaints of potential fraud, waste, abuse, and ethical matters related to the PASSHE organization. An external contractor was hired to provide the incident reporting services to PASSHE, and the Office of Internal Audit and Risk Assessment will be responsible for managing the incident reporting operation.

- Former PASSHE Chancellor Dr. John C. Cavanaugh accepted a position in Washington, D.C., effective March 1, 2013. In August 2013, the PASSHE Board of Governors selected **Mr. Frank T. Brogan** to serve as PASSHE's Chancellor beginning October 1, 2013. Within the last two years, new presidents have taken office at East Stroudsburg, Edinboro, Indiana, Lock Haven, Slippery Rock, Mansfield, and Millersville Universities of Pennsylvania. Interim presidents are serving at California and Shippensburg Universities of Pennsylvania.

- 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, 2013	June 30, 2012
Current Assets		
Cash and cash equivalents	$ 35,887	$ 23,713
Short-term investments	406,478	431,145
Accounts receivable, students, net of allowance for doubtful accounts of $28,121 in 2013 and $22,462 in 2012	45,915	50,127
Accounts receivable, other	12,820	10,743
Governmental grants and contracts receivable	27,263	54,394
Inventories	3,624	3,863
Prepaid expenses	8,400	8,654
Current portion of loans receivable, net	6,360	5,302
Due from component units	19,345	13,467
Other current assets	2,257	3,436
Total Current Assets	568,349	604,844
Noncurrent Assets		
Restricted cash and cash equivalents	25	25
Endowment investments	25,702	27,679
Other long-term investments	894,724	857,690
Due from component units	14,099	11,581
Loans receivable, net of allowance for doubtful accounts of $5,791 in 2013 and $6,047 in 2012	27,466	29,120
Capital Assets:		
Land	29,263	27,606
Buildings, including improvements	1,953,267	1,888,922
Improvements other than buildings	242,462	232,226
Equipment and furnishings	445,431	425,040
Library books	83,911	83,960
Construction in progress	103,782	92,627
	2,858,116	2,750,381
Less accumulated depreciation	(1,228,541)	(1,126,994)
Capital assets, net	1,629,575	1,623,387
Other noncurrent assets	2,736	2,786
Total Noncurrent Assets	2,594,327	2,552,268
Total Assets	$ 3,162,676	$ 3,157,112

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Balance Sheet

(dollars in thousands)

Liabilities and Net Position

	June 30, 2013	June 30, 2012
Current Liabilities		
Accounts payable and accrued expenses	$ 145,133	$ 151,992
Unearned revenue	53,140	54,822
Deposits	7,052	9,337
Current portion of workers' compensation liability	4,803	4,755
Current portion of compensated absences liability	11,585	11,656
Current portion of postretirement benefits liability	56,154	56,635
Current portion of capitalized lease obligations	3,345	8,893
Current portion of bonds payable	46,970	41,913
Due to component units	9,515	12,276
Other current liabilities	55,198	46,010
Total Current Liabilities	392,895	398,289
Noncurrent Liabilities		
Unearned revenue	3,383	3,545
Deposits	388	362
Workers' compensation liability	16,541	15,008
Compensated absences liability	98,324	96,550
Postretirement benefits liability	877,536	807,760
Capitalized lease obligations	53,537	46,627
Bonds payable	852,835	899,802
Other noncurrent liabilities	69,289	76,442
Total Noncurrent Liabilities	1,971,833	1,946,096
Total Liabilities	2,364,728	2,344,385
Net Position		
Net investment in capital assets	653,720	621,400
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	9,868	24,305
Other	1,271	1,251
Expendable:		
Scholarships and fellowships	32,114	12,699
Research	644	731
Student loans	1,513	432
Capital projects	39,653	38,030
Other	7,420	8,771
Unrestricted	51,745	105,108
Total Net Position	797,948	812,727
Total Liabilities and Net Position	$ 3,162,676	$ 3,157,112

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Statement of Revenues, Expenses, and Changes in Net Position
For the Years Ended June 30, 2013 and 2012
(dollars in thousands)

	2013		2012	
Operating Revenues				
Tuition and fees	$ 1,015,386		$ 1,010,294	
Less scholarship discounts and allowances	(211,187)		(223,877)	
Net tuition and fees		$ 804,199		$ 786,417
Governmental grants and contracts:				
Federal		42,161		46,453
State		104,167		117,550
Local		3,800		4,027
Nongovernmental grants and contracts		7,790		6,966
Sales and services		34,749		33,535
Auxiliary enterprises, net of discounts of $890 in 2013 and $659 in 2012		332,890		327,139
Other revenues		9,777		23,205
Total Operating Revenues		1,339,533		1,345,292
Operating Expenses				
Instruction		704,473		683,429
Research		5,419		6,591
Public service		34,233		33,844
Academic support		170,773		158,935
Student services		170,270		166,300
Institutional support		258,068		251,352
Operations and maintenance of plant		143,214		137,128
Depreciation		119,536		113,154
Student aid		74,488		76,592
Auxiliary enterprises		243,320		235,488
Total Operating Expenses		1,923,794		1,862,813
Operating Loss		(584,261)		(517,521)
Nonoperating Revenues (Expenses)				
State appropriations, general and restricted		412,751		412,751
Pell grants		140,585		145,697
Investment income, net of related investment expense of $432 in 2013 and $434 in 2012		20,409		24,465
Unrealized gain (loss) on investments		(5,131)		11,687
Gifts for other than capital purposes		15,124		15,362
Interest expense on capital asset-related debt		(38,786)		(41,617)
Loss on disposal of assets		(6,347)		(2,312)
Other nonoperating revenue		1,334		1,308
Net Nonoperating Revenues		539,939		567,341
Income (loss) before other revenues		(44,322)		49,820
State appropriations, capital		14,835		9,748
Capital gifts and grants		14,708		12,046
Increase (Decrease) in Net Position		(14,779)		71,614
Net postion—beginning of year		812,727		741,113
Net position—end of year		$ 797,948		$ 812,727

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Statement of Cash Flows
For the Years Ended June 30, 2013 and 2012

(dollars in thousands)

	2013	2012
Cash Flows from Operating Activities		
Tuition and fees	$ 804,269	$ 786,282
Grants and contracts	184,169	162,611
Payments to suppliers for goods and services	(440,752)	(406,141)
Payments to employees	(1,219,854)	(1,216,389)
Loans issued to students	(5,474)	(5,153)
Loans collected from students	6,069	6,746
Student aid	(75,070)	(77,033)
Auxiliary enterprise charges	333,303	326,124
Sales and services	36,138	33,136
Other receipts (payments)	(15,329)	23,576
Net cash used in operating activities	(392,531)	(366,241)
Cash Flows from Noncapital Financing Activities		
State appropriations	412,751	412,751
Gifts and nonoperating grants for other than capital purposes	155,542	161,003
PLUS, Stafford, and other loans receipts (non-Perkins)	792,193	890,468
PLUS, Stafford, and other loans disbursements (non-Perkins)	(792,245)	(890,396)
Agency transactions, net	15,053	13,632
Other	1,334	1,308
Net cash provided by noncapital financing activities	584,628	588,766
Cash Flows from Capital Financing Activities		
Proceeds from capital debt and leases	-	202,982
Capital appropriations	13,897	8,338
Capital grants and gifts received	11,154	9,792
Proceeds from sales of capital assets	80	36
Purchases of capital assets	(114,235)	(167,345)
Principal paid on capital debt and leases	(50,952)	(144,200)
Interest paid on capital debt and leases	(45,156)	(27,973)
Net cash used in capital financing activities	(185,212)	(118,370)
Cash Flows from Investing Activities		
Proceeds from sales and maturities of investments	22,100,511	23,828,180
Interest on investments	20,718	24,472
Purchase of investments	(22,115,940)	(23,955,234)
Net cash provided by (used in) investing activities	5,289	(102,582)
Net Increase in Cash and Cash Equivalents	12,174	1,573
Cash and cash equivalents—beginning of year	23,738	22,165
Cash and cash equivalents—end of year	$ 35,912	$ 23,738

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Statement of Cash Flows
For the Years Ended June 30, 2013 and 2012

(dollars in thousands)

	2013	2012
Reconciliation of Operating Loss to Net Cash Used in Operating Activities		
Operating loss	$ (584,261)	$ (517,521)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	119,536	113,154
Expenses paid by Commonwealth or donor	251	1,344
Changes in assets and liabilities:		
Receivables, net	33,123	(12,619)
Inventories	239	(64)
Other assets	(11,937)	15,047
Accounts payable	(10,302)	(44,791)
Unearned revenue	(1,751)	340
Student deposits	(2,259)	658
Compensated absences	1,703	6,377
Loans to students and employees	595	1,593
Other liabilities	62,532	70,241
Net cash used in operating activities	$ (392,531)	$ (366,241)
Noncash Capital Financing Activities		
Capital assets included in payables or acquired by gift	$ 6,780	$ 6,382
Capital assets acquired through capital leases	$ 10,345	$ 13,259
Like-kind exchanges	$ 1,451	$ 13

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Component Units Statement of Financial Position

(dollars in thousands)

	June 30, 2013	June 30, 2012
Assets		
Cash and cash equivalents	$ 131,195	$ 111,029
Accounts receivable	5,197	4,792
Contributions/pledges receivable	15,938	19,122
Due from universities	10,359	12,600
Inventories	8,030	9,279
Short-term investments	32,606	29,606
Investments	483,326	336,422
Capital assets:		
Land	26,866	25,216
Buildings	1,011,029	916,314
Building improvements	14,787	14,909
Improvements other than buildings	9,124	8,597
Equipment and furnishings	73,344	68,028
Construction in progress	85,161	73,656
	1,220,311	1,106,720
Less accumulated depreciation	(193,895)	(159,507)
Capital assets, net	1,026,416	947,213
Other assets	135,492	142,308
Total Assets	$ 1,848,559	$ 1,612,371
Liabilities		
Accounts payable and accrued expenses	$ 35,704	$ 37,767
Annuity liabilities	8,040	8,699
Due to universities	33,422	22,868
Deposits payable	19,553	16,398
Capitalized leases	31,562	32,620
Bonds payable	1,106,805	909,170
Notes payable	225,431	218,730
Other liabilities	97,206	130,050
Total Liabilities	1,557,723	1,376,302
Net Assets		
Unrestricted	(4,737)	(31,481)
Temporarily restricted	77,380	70,018
Permanently restricted	218,193	197,532
Total Net Assets	290,836	236,069
Total Liabilities and Net Assets	$ 1,848,559	$ 1,612,371

See accompanying notes to financial statements.

Pennsylvania State System of Higher Education

Component Units Statement of Activities
For the Years Ended June 30, 2013 and 2012

(dollars in thousands)

	2013	2012
Revenues and Gains		
Contributions	$ 34,231	$ 33,921
Sales and services	50,059	49,360
Student fees	33,818	33,753
Grants and contracts	9,845	11,171
Rental income	128,023	111,953
Investment income	11,389	8,133
Unrealized gains (losses) related to investment activity	54,033	(58,089)
Other revenues and gains	8,947	13,045
Total Revenues and Gains	330,345	203,247
Expenses and Losses		
Program services:		
Scholarships and grants	11,576	10,501
Student activities and programs	30,991	28,278
University stores	33,476	32,068
Housing	127,830	110,144
Other university support	23,146	21,364
Other programs	13,716	20,278
Management and general	26,448	24,736
Fundraising	8,395	7,380
Total Expenses and Losses	275,578	254,749
Change in Net Assets	54,767	(51,502)
Net assets—beginning of year	236,069	287,571
Net assets—end of year	$ 290,836	$ 236,069

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

Years Ended June 30, 2013 and 2012

(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.

The accompanying financial statements of the component units, which are all private nonprofit organizations, are reported in accordance with Financial Accounting Standards Board (FASB) requirements, including FASB Statement No. 117, *Financial Reporting for Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications for these differences have been made to the component units' financial information presented herein.

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 Position *(formerly referred to as Net Assets)*
PASSHE maintains the following classifications of net position. The term "net position" has replaced the term "net assets" as required by GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*.

Net investment in capital assets (previously referred to and the same as "Invested in capital assets, net of related debt"; the terminology was changed by GASB in Statement No. 63): 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: The portion of net position subject to externally imposed conditions requiring that it be maintained by PASSHE in perpetuity.

Restricted—expendable: The portion of net position use of which 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 position. Unrestricted net position 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 using 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, 2013 and 2012.

Unearned Revenue *(previously Deferred Revenue)*
Unearned 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. PASSHE previously referred to "unearned revenue" as "deferred revenue," but changed the terminology in accordance with new GASB requirements.

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 was required to adopt Statement No. 60 for the fiscal year ending June 30, 2013. PASSHE has determined that Statement No. 60 has no effect 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 assets*" with "*net position*," 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 was required to adopt Statement No. 63 for the fiscal year ending

June 30, 2013, and is required to adopt Statement No. 65 for the fiscal year ending June 30, 2014. PASSHE has determined that Statement No. 63 has no effect on the substance of its financial statements; however, the changes increase the complexity of the financial statements to its readers, as the new presentation differs from the traditional and familiar business reporting model. PASSHE has determined that the adoption of Statement No. 65 will require that bond issuance costs, which previously were netted against the associated bond discount or bond premium on the balance sheet and amortized over the life of the associated bond payable, now will be expensed in the period incurred. The amount of fiscal year 2012/13 bond issuance costs that will be restated as an expense on next year's financial statements is $6,151,000.

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. Statement No. 68 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.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*. Statement No. 69 establishes accounting and financial reporting standards related to government combinations and disposals of government operations. In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. Statement No. 70 specifies the information required to be disclosed by governments that extend nonexchange financial guarantees. PASSHE has determined that Statements No. 69 and 70 have no 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 the 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 sometimes are 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, 2013 and 2012, the carrying amount of PASSHE's demand and time deposits and certificates of deposit for all funds was $35,935,000 and $23,761,000, respectively, compared to bank balances of $36,437,000 and $22,470,000, respectively. The difference is caused primarily by items in transit. Of the bank balances, $6,065,000 and $3,529,000, 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; $1,547,000 and $2,302,000, respectively, were uninsured and uncollateralized; and $28,825,000 and $16,639,000, 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, 2013 and 2012, follow.

PASSHE Pooled Deposits and Investments
June 30, 2013
(in thousands)

	Moody's Rating (if applicable)	**Modified Duration** (if applicable)	**Fair Value**
Deposits			
Money market funds			$19,105
Total deposits			19,105
Investments			
Repurchase agreements			14,260
Commercial paper	P1	0.06	138,604
U.S. government and agency obligations	Aaa	2.94	475,390
Asset-backed securities	Aaa	0.96	80,275
	P1	0.22	95,200
Collateralized mortgage obligations (CMOs)	Aaa	2.16	228,091
Corporate bonds and notes	Aaa	1.66	29,042
	Aa1	4.73	4,683
	Aa2	1.80	24,106
	Aa3	1.39	40,800
	A1	1.29	26,236
	A2	2.30	42,073
	A3	2.49	33,373
	Baa1	1.83	25,309
	Baa2	2.36	30,258
	Baa3	0.00	725
Total investments			1,288,425
Total deposits and investments			$1,307,530

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

Of the investments noted above at June 30, 2013 and 2012, $17,071,000 and $36,525,000, respectively, were held by a trustee to be used for projects funded under the Pennsylvania Higher Educational Facilities Authority/State System of Higher Education bond issues (note 9). Investments are made subject to the restrictions of the bond indenture and may be liquidated only for the payment of costs associated with the projects described in the bond indenture.

The carrying values (fair values) of local university deposits and investments on June 30, 2013 and 2012, follow.

University Local Deposits and Investments
June 30, 2013
(in thousands)

	Moody's Rating (if applicable)	**Modified Duration** (if applicable)	**Fair Value**
Deposits			
Demand and time deposits			$16,807
Certificates of deposit			23
Total deposits			16,830
Investments			
U.S. government and agency obligations		2.00	414
Bond mutual funds		5.45	5,266
Debt securities		4.77	54
Equity/balanced mutual funds			29,798
Common stock			2,924
Total investments			38,456
Total deposits and investments			$55,286

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

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

(in thousands)

		Fair Value	
Investment	**Currency**	June 30, 2013	June 30, 2012
Deposit	British Pound	$12	$44

The universities are beneficiaries of trust funds held by others with an approximate fair value of $3,870,000 and $3,608,000 on June 30, 2013 and 2012, respectively. Since the universities have neither possession nor control of these trusts, the principal is not included in the accompanying balance sheet.

(3) Leases

Total rent expense for PASSHE operating leases amounted to $8,292,000 and $7,773,000 for the years ended June 30, 2013 and 2012, respectively.

Capital assets acquired through leases that have been capitalized are as follows:

(in thousands)

	June 30, 2013	June 30, 2012
Cost:		
Construction in Progress	$9,820	-
Buildings	65,599	$72,384
Equipment	3,490	4,797
Total	$78,909	$77,181
Accumulated Depreciation:		
Buildings	$25,216	$21,708
Equipment	1,785	2,089
Total	$27,001	$23,797

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
2014	$7,092	$5,973
2015	5,995	5,626
2016	4,950	5,369
2017	3,140	5,271
2018	1,660	5,179
Thereafter	41,535	53,001
Total minimum lease payments	$64,372	80,419
Amount representing interest on capital leases		23,537
Present value of net minimum capital lease payments		$56,882

Changes in the liability for capital leases in fiscal years 2013 and 2012 follow.

(in thousands)

Year	Beginning Balance	Capital Lease Additions	Capital Lease Payments	Ending Balance
2012	$46,436	$13,259	$4,175	$55,520
2013	$55,520	$10,345	$8,983	$56,882

(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 benefit 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 6.18% of annual covered payroll at June 30, 2013. PASSHE's contributions to PSERS for the years ended June 30, 2013, 2012, and 2011, were $2,752,000, $1,769,000, and $1,481,000, 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 8.43% and 10.51% of active members' annual covered payroll at June 30, 2013. PASSHE's contributions to SERS for the years ended June 30, 2013, 2012, and 2011, were $30,490,000, $20,643,000, and $13,032,000, 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, 2013 and 2012, was 9.29% of qualifying compensation. The contributions to the ARP for the years ended June 30, 2013 and 2012, were $43,080,000 and $41,978,000, respectively, from PASSHE; and $23,633,000 and $23,165,000, 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 and 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 $42,975,000 and $38,729,000 for the fiscal years ending June 30, 2013 and 2012, 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, 2013:

- Eligible plan members receiving benefits who retired prior to July 1, 2005, are not required to make contributions.
- Nonfaculty coaches who retired on or after July 1, 2005, 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 July 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, and future adjustments will apply if contributions increase for active employees.
- Other eligible annuitants who retire on or after July 1, 2008, pay 15% of the plan premium in effect on their retirement date. Future adjustments will apply if contributions increase for active employees.

Total contributions made by plan members were $3,607,000 and $3,189,000, or approximately 7.7% and 7.6% of the total premiums, for the fiscal years ending June 30, 2013 and 2012, 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, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. 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)	June 30, 2013	June 30, 2012
Annual required contribution	$120,129	$116,548
Interest on net OPEB obligation	36,737	35,615
Adjustment to ARC	(44,596)	(40,491)
Annual OPEB cost (expense)	112,270	111,672
Contributions made	(42,975)	(38,729)
Increase in net OPEB obligation	69,295	72,943
Net OPEB obligation at July 1	864,395	791,452
Net OPEB obligation at June 30	$933,690	$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, 2013, 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, 2011	$106,123	35.1%	$791,452
June 30, 2012	$111,672	34.7%	$864,395
June 30, 2013	$112,270	38.3%	$933,690

Funded Status and Funding Progress
The funded status of the plan as of July 1, 2012, the most recent actuarial valuation date, was as follows.

(in thousands)	
Actuarial accrued liability (AAL)	$1,420,502
Actuarial value of plan assets	0
Unfunded actuarial accrued liability (UAAL)	$1,420,502
Funded ratio (actuarial value of plan assets/AAL)	0%
Covered payroll (active plan members)	$566,753
UAAL as a percentage of covered payroll	251%

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, 2012, actuarial valuation, the projected unit credit method was used. The actuarial assumptions included a 4.25% investment rate of return, which is the expected rate to be earned on PASSHE's operating portfolio, and annual health care cost trend rates of 8.0% for pre-Medicare and 7.0% for post-Medicare 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, 2012, was 23 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, 2005, are not required to make contributions. Plan members who enrolled after July 1, 2005, 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 2012/13, PASSHE contributed $265 for each current active employee per biweekly pay period. PASSHE made contributions of $25,638,000, $23,228,000, and $20,069,000 for the fiscal years ending June 30, 2013, 2012, and 2011, 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 $1,854,000 and $2,004,000 to the Reserve Fund during the years ended June 30, 2013 and 2012, respectively.

For the years ended June 30, 2013 and 2012, the aggregate liability for claims under the self-insurance limit was $10,650,000 and $10,243,000, respectively. The Reserve Fund assets of $10,694,000 and $9,520,000 are equal to the liability for claims in excess of the self-insurance limits for the years ended June 30, 2013 and 2012, respectively. Changes in the workers' compensation claims liability in fiscal years 2013 and 2012 follow.

(in thousands)

Year	Beginning Balance	Current Year Claims and Changes in Estimates	Claim Payments	Ending Balance
2012	$18,985	$5,888	$5,110	$19,763
2013	$19,763	$5,921	$4,340	$21,344

(7) Compensated Absences

Changes in the compensated absences liability in fiscal years 2013 and 2012 are as follows.

(in thousands)

Year	Beginning Balance	Current Changes in Estimates	Less Payouts	Ending Balance
2012	$101,828	$14,837	$8,459	$108,206
2013	$108,206	$11,887	$10,184	$109,909

(8) Termination Benefits

In March 2013, the Board approved a Voluntary Retirement Incentive Program for APSCUF employees meeting certain age and service requirements. Eligible faculty who indicated their intent to retire by May 31, 2013, and eligible coaches who indicated their intent to retire by June 28, 2013, qualified for a cash incentive payout of between $10,000 and $30,000, depending on base salary and years of service. A total of 135 eligible PASSHE employees accepted the offer by signing a release and settlement agreement releasing PASSHE from all legal claims related to their employment and retirement. For the year ended June 30, 2013, PASSHE recorded an expense of $3,609,000 for the cash incentive and $219,000 for associated Social Security and Medicare taxes, for a total expense of $3,828,000. The cash incentive is not eligible for retirement benefits.

(9) Bonds Payable

Bonds payable on June 30, 2013 and 2012, 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, 2013 and 2012, was as follows.

Bonds Payable
June 30, 2013 and 2012
(in thousands)

Description	Original Issuance	Weighted Average Interest Rate	Balance June 30, 2011	2012 Bonds Issued	2012 Bonds Redeemed/ Refunded	Balance June 30, 2012	2013 Bonds Issued	2013 Bonds Redeemed/ Refunded	Balance June 30, 2013	Current Portion
Series U issued August 2002, final maturity June 2022	$14,400	4.43%	$8,090	-	$8,090	-	-	-	-	-
Series W issued October 2002, final maturity June 2020	69,105	4.76%	60,930	-	60,930	-	-	-	-	-
Series X issued May 2003, final maturity June 2023	80,910	4.28%	31,470	-	31,470	-	-	-	-	-
Series Z issued March 2004, final maturity June 2024	71,760	4.04%	43,105	-	1,875	$41,230	-	$1,930	$39,300	$1,985
Series AA issued July 2004, final maturity June 2024	28,750	4.65%	19,055	-	1,605	17,450	-	1,665	15,785	1,750
Series AC issued July 2005, final maturity June 2025	52,650	4.89%	39,120	-	2,540	36,580	-	2,675	33,905	2,810
Series AE issued July 2006, final maturity June 2036	103,290	4.98%	87,315	-	3,645	83,670	-	3,835	79,835	4,030
Series AF issued July 2007, final maturity June 2037	68,230	5.00%	60,845	-	2,020	58,825	-	2,105	56,720	2,195
Series AG issued March 2008, final maturity June 2024	101,335	4.75%	86,440	-	4,540	81,900	-	4,395	77,505	7,000
Series AH issued July 2008, final maturity June 2038	140,760	4.70%	130,500	-	3,645	126,855	-	3,830	123,025	4,020
Series AI issued August 2008, final maturity June 2025	32,115	4.10%	26,900	-	1,665	25,235	-	1,725	23,510	1,785
Series AJ issued July 2009, final maturity June 2039	123,985	4.89%	117,745	-	3,720	114,025	-	4,225	109,800	4,515
Series AK issued Sept. 2009, final maturity June 2024	47,310	3.79%	43,010	-	3,485	39,525	-	3,580	35,945	3,705
Series AL issued July 2010, final maturity June 2035	135,410	5.00%	130,765	-	7,180	123,585	-	7,705	115,880	8,115
Series AM issued July 2011, final maturity June 2036	119,085	4.68%	-	$119,085	3,060	116,025	-	3,865	112,160	3,990
Series AN issued March 2012, final maturity June 2023	76,810	4.90%	-	76,810	-	76,810	-	375	76,435	1,070
Total	**$1,265,905**	**-**	**$885,290**	**$195,895**	**$139,470**	**$941,715**	**-**	**$41,910**	**$899,805**	**$46,970**

Principal and interest requirements to maturity are as follows.

(in thousands)	Principal	Interest	Total
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	61,030	32,072	93,102
2019–2023	301,650	115,299	416,949
2024–2028	186,265	52,970	239,235
2029–2033	92,385	20,154	112,539
2034–2038	33,520	3,663	37,183
2039	280	14	294
Total	**$899,805**	**$380,836**	**$1,280,641**

(10) Rating Actions

Subsequent to its July 2012 rating action downgrading the Commonwealth from Aa1 to Aa2, Moody's Investors Service, Inc., downgraded PASSHE's outstanding bonds from Aa2 to a rating of Aa3 in October 2012. PASSHE's other major rating agency, Fitch Ratings, took no downgrading action and continues to rate PASSHE's bonds as AA.

(11) Capital Assets

The classifications of capital assets and related depreciation at June 30, 2013 and 2012, follow.

(in thousands)	Balance June 30, 2011	2011/12 Additions	2011/12 Retirements/ Adjustments	Balance June 30, 2012	2012/13 Additions	2012/13 Retirements/ Adjustments	Balance June 30, 2013
Land	$26,304	$987	$315	$27,606	$1,657	-	$29,263
Construction in progress	175,278	75,983	(158,634)	92,627	65,413	($54,258)	103,782
Total capital assets not being depreciated	201,582	76,970	(158,319)	120,233	67,070	(54,258)	133,045
Buildings, including improvements	1,687,780	73,283	127,859	1,888,922	39,741	24,604	1,953,267
Improvements other than buildings	223,831	3,374	5,021	232,226	6,516	3,720	242,462
Equipment and furnishings	388,202	32,028	4,810	425,040	24,688	(4,297)	445,431
Library books	83,810	1,342	(1,192)	83,960	1,331	(1,380)	83,911
Total capital assets being depreciated	2,383,623	110,027	136,498	2,630,148	72,276	22,647	2,725,071
Less accumulated depreciation							
Buildings and improvements	(568,326)	(71,357)	2,531	(637,152)	(76,504)	10,046	(703,610)
Land improvements	(95,316)	(9,090)	886	(103,520)	(9,194)	435	(112,279)
Equipment and furnishings	(298,280)	(30,292)	14,837	(313,735)	(31,589)	6,238	(339,086)
Library books	(71,345)	(2,415)	1,173	(72,587)	(2,249)	1,270	(73,566)
Total accumulated depreciation	(1,033,267)	(113,154)	19,427	(1,126,994)	(119,536)	17,989	(1,228,541)
Total capital assets being depreciated, net	1,350,356	(3,127)	155,925	1,503,154	(47,260)	40,636	1,496,530
Capital assets, net	$1,551,938	$73,843	($2,394)	$1,623,387	$19,810	($13,622)	$1,629,575

(12) Contingencies and Commitments

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, 2013 and 2012, were approximately $58,155,000 and $100,049,000, respectively.

(13) Subsequent Events

In July 2013, PHEFA issued Series AO revenue bonds, comprising $12,340,000 in tax-exempt revenue bonds and $18,575,000 in taxable revenue bonds. The net proceeds from the Series AO revenue bonds were used to finance capital projects at several universities. In connection with the bond issuance, PASSHE entered into a loan agreement with PHEFA under which PASSHE pledged its full faith and credit for repayment of bonds.

REQUIRED SUPPLEMENTARY INFORMATION

Years Ended June 30, 2013 and 2012

(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, 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%
July 1, 2012	$0	$1,420,502	$1,420,502	0%	$566,753	251%

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, 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%
July 1, 2012	$71,630	$12,843,700	$12,772,070	.56%	$4,130,000	309%

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