PENNSYLVANIA'S STATE SYSTEM OF HIGHER EDUCATION

Pennsylvania's
STATE SYSTEM
of Higher Education

FINANCIAL STATEMENTS
JUNE 30, 2018

Pennsylvania's State System of Higher Education
Financial Statements
June 30, 2018

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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 Pennsylvania's State System of Higher Education ("the State System"), a component unit of the Commonwealth of Pennsylvania as of and for the years ended June 30, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the State System'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 opinions on these financial statements based on our audit. We did not audit the financial statements of certain of the discretely presented component units, which represent 81.5 percent, 82.7 percent, and 79.8 percent, respectively, of the 2018 assets, net assets, and revenues and 82.3 percent, 85.9 percent, and 79.6 percent, respectively, of the 2017 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 audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 opinions.

Opinions

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 respective financial position of the business-type activities and the aggregate discretely presented component units of the State System as of June 30, 2018 and 2017, 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.

Emphasis of Matter

As discussed in Note (1) to the financial statements, the State System implemented the provisions of Governmental Accounting Standards Board (GASB) Statements No. 75 – *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* and No. 81 – *Irrevocable Split-Interest Agreements,* for the year ended June 30, 2018, which represent changes in accounting principle. As of July 1, 2017, the State System’s net position was restated to reflect the impact of adoption. A summary of the restatement is presented in Note (1). Our opinion is not modified with respect to this matter.

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 3-18, and the various schedules of Proportionate Share of Net Pension Liability, OPEB Liability, Proportionate Share of Net OPEB Liability, and Contributions on pages 55-58 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.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Harrisburg, Pennsylvania
September 26, 2018

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Unaudited)

As members of the Commonwealth of Pennsylvania's (Commonwealth) public four-year higher education system, the 14 universities of Pennsylvania's State System of Higher Education (State System) are charged with providing high-quality education at the lowest possible cost to the students. With approximately 100,000 degree-seeking students enrolled, and thousands more enrolled in certificate and other career-development programs, the State System is the state's largest higher education provider. Students can choose from 190 undergraduate programs and 123 graduate programs offered in 30 major academic areas, as well as certification programs offered in 144 areas.

The campuses of the 14 universities encompass more than 4,700 acres and 900 physical plant structures. The universities function independently, but being part of the State System enables them to share administrative resources and academic courses and benefit from economies of scale.

The State System's financial statements comprise:

- Bloomsburg University of Pennsylvania.
- California University of Pennsylvania.
- Cheyney University of Pennsylvania.
- Clarion University of Pennsylvania, including its branch campus in Oil City.
- East Stroudsburg University of Pennsylvania.
- Edinboro University of Pennsylvania.
- Indiana University of Pennsylvania, including its branch campuses in Freeport and Punxsutawney.
- Kutztown University of Pennsylvania.
- Lock Haven University of Pennsylvania, including its branch campus in Clearfield.
- Mansfield University of Pennsylvania.
- Millersville University of Pennsylvania.
- Shippensburg University of Pennsylvania.
- Slippery Rock University of Pennsylvania.
- West Chester University of Pennsylvania.
- Office of the Chancellor, including the Dixon University Center in Harrisburg and the State System @ Center City Philadelphia.

Following is an overview of the State System's financial activities for the year ended June 30, 2018, as compared to the year ended June 30, 2017. The tables throughout do not include the effects of Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, or Statement No. 81, *Irrevocable Split-Interest Agreements*, for years presented prior to fiscal year 2017/18.

FINANCIAL HIGHLIGHTS

In fiscal year 2017/18, the State System received $453.1 million in General Fund **appropriations** from the Commonwealth, a 2.0% increase over the $444.2 million received in the prior fiscal year. Over the last three years, state appropriations have increased $40.4 million, or 9.8%, but still are about $51 million less than received in fiscal year 2007/08, just before the onset of the recession that severely impacted both the state and national economies and led to several years of funding cuts to the State System.

The State System received an $18.0 million Realty Transfer Tax allocation from the Commonwealth's **Key '93** (Keystone Recreation, Park and Conservation) Fund, an increase of $1.9 million, or 11.8%, from fiscal year 2016/17. With the exception of fiscal years 2009/10 and 2010/11, when no funding was received, Key '93 funds have provided a consistent revenue stream for university deferred maintenance projects since 1993.

The State System was allocated $65 million in **Commonwealth capital funding** for fiscal year 2017/18, primarily for the renovation or replacement of existing educational and general (E&G) buildings. The State System has been allocated $65 million in Commonwealth capital funding annually since fiscal year 2000/01, except for fiscal years 2009/10 and 2010/11, when the capital funding allocated to the State System was $130 million each year. Except for associated furnishings and equipment, the universities do not record the value of Commonwealth-funded capital projects as revenue, since the Commonwealth retains title to any part of a capital project for which they directly provide funding.

To reward the universities for demonstrated success and continued improvement in student achievement, university excellence, and operational efficiency, and as a driver to better serve students and the Commonwealth, the State System's Board of Governors (Board) allocated $39.1 million of the general fund appropriation for **performance funding** in fiscal year 2017/18, equal to the amount allocated in fiscal year 2016/17. Performance funding allocated in fiscal year 2015/16 was $38.5 million.

Fall 2017 student headcount was 102,301, a decrease of 2,471 students, or 2.4%, from fall 2016. This is the seventh year in a row that the State System has experienced an **enrollment decline**, following 14 years of record growth.

Year	Fall Enrollment	% Change from Prior Year
2017	102,301	(2.4%)
2016	104,779	(2.2%)
2015	107,126	(2.3%)
2014	109,606	(2.2%)
2013	112,028	(2.1%)
2012	114,471	(3.2%)
2011	118,224	(1.1%)
2010	119,513	2.2%

Following is a breakdown of selected enrollment information, with nontraditional students defined as those 25 years of age or older:

Fall Enrollment

	2017/18		2016/17	
Full-time	84,098	82%	86,905	83%
Part-time	18,203	18%	17,874	17%
Total	102,301		104,779	
Undergraduate	86,971	85%	89,802	86%
Graduate	15,330	15%	14,977	14%
Total	102,301		104,779	
Traditional	82,537	81%	85,320	81%
Nontraditional	19,764	19%	19,459	19%
Total	102,301		104,779	

In academic year 2016/17, the universities awarded 25,541 degrees, a 2% increase over the 24,985 degrees awarded in academic year 2015/16, and a slight decrease from the 25,556 degrees awarded in academic year 2014/15.

Degrees Awarded (Academic Year)

	2016/17	2015/16	2014/15
Undergraduate	19,604	19,397	20,138
Master's	5,285	5,075	4,802
Doctoral	185	168	196
Associate's	467	345	420
Total	25,541	24,985	25,556

The Board approved a 2017/18 academic year base **tuition increase** of 3.5% over the 2016/17 academic year. The $127-per-semester increase sets the tuition rate for most full-time Pennsylvania residents—who comprise about 90% of all State System university students—at $3,746 per term, or $7,492 for the full year**.** Nonresident, undergraduate tuition also increased by 3.5%, with rates ranging from $11,238 to $18,730 for the 2017/18 academic year. The resident graduate tuition rate was $500 per credit, an increase of $17 over the prior year. The typical nonresident graduate tuition rate increased by $25 per credit, to $750.

The Board approved a $16 increase to the **technology tuition fee** ($464 annually) for full-time resident undergraduate students and a $24 increase ($706 annually) for full-time nonresident undergraduate students. All funds raised by the technology tuition fee are used directly to benefit student learning. Universities have used the funds to install multimedia classrooms, design online instructional materials, increase university capacity for connectivity for students, and provide hardware, software, and support for students and faculty, among other projects.

Mandatory student fees set by the universities increased, on average, by 5.1%. These increases, combined with the increase in tuition and reduction in enrollment, resulted in tuition and mandatory fee revenue (before discounts) of $1.12 billion, a 0.2% increase over fiscal year 2016/17. The average increase in mandatory student fees in fiscal year 2016/17 was 6.9% over the prior year.

Auxiliary revenue from **room and board fees** (excluding privatized student housing revenue recorded by affiliates) was $265.9 million in fiscal year 2017/18, a decrease of $9.7 million, or 3.5%, from fiscal year 2016/17. This compares to a fiscal year 2016/17 increase of 3.2%, or $8.5 million, in room and board revenues over the prior fiscal year. The fiscal year 2017/18 decrease is attributed primarily to the decline in enrollment, while the 2016/17 increase was a result of the additional room fees from student housing that was newly acquired by several universities from their affiliated organizations.

The State System's typical **price of attendance** (tuition, mandatory fees, room, and board) of $21,481 in 2017/18 was $711 above the average among all four-year public universities in the United States, but $1,174 less than the average for the Middle States region, which was $22,655.

The State System purchased $159.8 million in **capital assets** in fiscal year 2017/18, which included $138.5 million to build or improve academic and auxiliary facilities across all 14 universities.

During fiscal year 2017/18, the State System issued Series AU bonds, totaling $128.3 million. Of this amount, $91.7 million was used to advance refund a portion of the Series AH bonds, and the remaining $36.6 million was used to undertake various **capital projects** at the universities, comprising:

- $2.6 million to renovate and repurpose a residence hall and $2.2 million in athletic stadium compliance upgrades and improvements at Indiana University.
- $4.9 million in compliance upgrades and other improvements for the library, $4.9 million in renovations of a classroom building, and $13.3 million in energy improvements and upgrades at Slippery Rock University.
- $8.7 million to construct a parking garage at West Chester University.

Bond principal of $68.6 million and bond interest of $46.8 million were paid, and $97.0 million of bond principal was refunded, bringing the total outstanding **bond debt** to $1.0 billion at June 30, 2018.

Moody's Investors Service, Inc., continues to assign an Aa3 credit rating to the State System's outstanding bonds. Fitch Ratings, Inc., has assigned the State System's bonds with an A+ rating, a downgrade from last year's AA- rating. In August 2018, both Moody's and Fitch revised their outlooks for the ratings **from negative to stable**.

The Financial Statements

Balance Sheet

The *Balance Sheet* reports the balances of the assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position of the State System as of the end of the fiscal year.

- *Assets* include cash; investments reported at market value; the value of outstanding receivables due from students and other parties; and land, buildings, and equipment reported at cost, less accumulated depreciation.

- *Deferred Outflows of Resources*, defined as a consumption of net position that applies to future periods, reports the deferred loss on bond defeasance and certain items associated with the pension and other postemployment benefits liabilities.

- *Liabilities* include payments due to vendors, employees, and students; revenues received but not yet earned; the balance of bonds payable; and amounts estimated to be due for items such as workers' compensation (the State System is self-insured), compensated absences (the value of sick and annual leave earned by employees), pension benefits, and other postemployment benefits (health and tuition benefits expected to be paid to certain current and future retirees).

- *Deferred Inflows of Resources*, defined as an acquisition of net position that applies to future periods, reports the deferred gain on bond defeasance and certain items associated with the pension and other postemployment benefits liabilities.

- *Net Position*, informally referred to as *Net Assets* or *Fund Balance* (as it was previously called), is the sum of Assets plus Deferred Outflows of Resources less Liabilities less Deferred Inflows of Resources.

Statement of Revenues, Expenses, and Changes in 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, the State System 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 gains and losses on disposals and acquisitions of assets as nonoperating. The State System classifies all of its remaining activities as operating.

Statement of Cash Flows

The *Statement of Cash Flows* provides information about the State System's cash receipts and cash payments. It can be used to determine the State System'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, the State System reports three components of net position:

- *Net investment in capital assets*, informally referred to as *NIP* (from its former name, *Net Investment in Plant*), 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 the State System'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 the State System 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 the corpus 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, chancellor, or university presidents have designated for specific purposes, auxiliary funds, and all other funds not appropriately classified as restricted or invested in capital assets.

Unrestricted net position includes **three liabilities that the State System does not fund**. Because these liabilities will be realized gradually over future years, and because of their size, the universities are expected to fund these liabilities only on a "pay-as-you-go" basis; i.e., as they become due.

- The liability for **compensated absences** represents the dollar value of annual and sick leave that employees have earned and could potentially receive in the form of cash payouts upon retirement or other termination. The dollar value is based on an employee's current salary. All full-time employees are eligible to be paid, upon termination, for the dollar value of the number of days of unused annual, personal, and holiday leave that they have accumulated, with a maximum annual leave accumulation of 45 days. The liability for annual leave is the dollar value of the total number of days that employees have accumulated at June 30. Sick leave payouts, however, are subject to vesting requirements, and the dollar value of accumulated unused sick leave is paid only to those employees who meet certain service and/or age requirements and is capped at various levels depending upon the number of days accumulated. The associated liability is estimated based on a calculation of historical leave payouts for terminated employees compared to the dollar value of sick days that the terminated employees had accumulated, applied to employees' current leave balances.

  As employees earn and accumulate leave, the compensated absences liability is increased; as employees use leave, and as terminated employees receive payouts, the liability is decreased. The compensated absences liability increased by $6.7 million to $126.2 million for the year ended June 30, 2018, compared to a $4.1 million increase from the prior year for the year ended June 30, 2017. Universities fund this liability only as cash payouts are made to employees for annual and vested sick leave balances upon termination or retirement.

- The **net pension liability** is the State System's allocated share of the difference between the Commonwealth's defined benefit pension obligations and the funding set aside by the Commonwealth in a qualified trust to pay the future benefits that are promised to current employees, retirees, and their beneficiaries. The annual increase in the liability is the amount that current employees earn each fiscal year as a pension benefit, actuarially calculated based on years of service, age, and estimates of future service and employee longevity. The liability decreases when funding of the qualified trust increases and when employees or retirees leave the pension plans. The liability decreased by $84.7 million to $937.8 million for the year ended June 30, 2018, primarily due to improved interest rates, compared to an increase of $83.9 million for the year ended June 30, 2017. Universities fund this liability on a "pay-as-you-go" basis; that is, they fund only the annual contractually required contributions to the State Employees Retirement System (SERS) and the Public School Employees Retirement System (PSERS).

- The liability for **other postemployment benefits, or OPEB,** represents the estimated future healthcare costs for current and future retirees. The annual increase in the liability is the amount that current employees earn each fiscal year as a retiree healthcare benefit, actuarially calculated based on years of service, age, and estimates of future service and employee longevity. The liability also increases as healthcare costs increase. The liability decreases when required contributions by retirees are increased, when the number of eligible employees decreases, and when retirees leave the plan. The liability increased by $1.18 billion to $2.32 billion for the year ended June 30, 2018, compared to an increase of $38.5 million for the year ended June 30, 2017. This exceptionally large increase primarily was due to the implementation of GASB Statement No. 75 and comprises the following:
  - $315.0 million increase for the State System plan, a self-insured plan administered by the State System. Under GASB Statement No. 45, the liability recorded at June 30, 2017, was $1.15 billion. With the implementation of GASB Statement No. 75, the June 30, 2017, liability increased to $1.56 billion, but dropped to $1.46 billion at June 30, 2018, primarily due to improved interest rates.
  - $860.9 million for the Retired Employees Health Program (REHP), administered by the Commonwealth, and not previously recorded as a State System liability.
  - $3.7 million for the PSERS Health Insurance Premium Assistance Program, administered by the Commonwealth, and not previously recorded as a State System liability.

Like the pension liability, universities fund these liabilities on a "pay-as-you-go" basis: For the State System plan, universities make biweekly contributions to fund the actual claims incurred by retirees during the year; for the REHP and PSERS OPEB plans, the universities make contractually required contributions as determined by the Commonwealth.

With the implementation of GASB Statement No. 75 in fiscal year 2017/18, the State System's combined liabilities related to **unfunded future pension and retiree healthcare costs now total $3.26 billion**. The System has virtually no control over $1.8 billion of this amount, which represents its share of the plans administered by the Commonwealth, since the Commonwealth determines the associated benefits as well as the employer and employee contribution rates for these plans.

Recently enacted Commonwealth **pension legislation** will modify the pension benefits for new hires, slowing the rate of growth of the pension liability, but it will not aid in reducing the existing liability. No legislation has been enacted or proposed to either reduce or slow the growth of the OPEB liabilities administered by the Commonwealth, in which the American Federation of State, County, and Municipal Employees (AFSCME) employees participate. The State System, however, closed the State System OPEB plan to new employees hired after January 2016, with the exception of the Association of Pennsylvania State College and University Faculties (APSCUF) employees. Although this will not reduce the existing liability, these new hires bring no additional liability, now or in the future.

The **Commonwealth's combined net pension and OPEB liabilities totaled $87.4 billion** at June 30, 2018. Credit rating agencies consistently site these growing liabilities as significant challenges for both the State System and the Commonwealth and as factors that have contributed to credit rating downgrades.

Following is a summary of the net pension and OPEB liabilities for the State System and the Commonwealth. The pension and OPEB liabilities are shown at the net amount; that is, net of any assets dedicated in a trust to fund the liabilities. The funded ratio equals the value of any trust assets as a percentage of the total liability. The State System's Alternative Retirement Plan (ARP) is a defined contribution plan and has no liability. The State System's OPEB plan is a defined benefit plan with no assets in a trust dedicated to fund the liability.

(in millions)

Summary of Net Pension and OPEB Liabilities for the State System and the Commonwealth

	June 30, 2018			June 30, 2017		
	State System Share	**Net Liabilities Commonwealth Plans**	**Plan Funded Ratio**	**State System Share***	**Net Liabilities Commonwealth Plans**	**Plan Funded Ratio**
SERS Pension	$848.3	$15,950.4	63.0%	$931.6	$17,767.1	57.8%
PSERS Pension	89.4	49,388.4	51.8%	90.8	49,556.8	50.1%
REHP OPEB Plan	860.9	20,054.3	1.4%	931.9	21,710.3	0.9%
PSERS OPEB Plan	3.7	2,037.4	5.7%	3.9	2,154.0	5.5%
Total Commonwealth Pension and OPEB Liabilities	1,802.3	$87,430.5		1,958.2	$91,188.2	
State System Alternative Retirement Plan	0		N/A	0		N/A
State System OPEB Plan	1,460.0		0%	1,559.1		0%
Total Pension and OPEB Liabilities	$3,262.3			$3,517.3		

Liabilities are shown net of the value of assets placed in a dedicated trust to fund the liability.
**The State System's share of the REHP and PSERS OPEB plans at June 30, 2017, were not recorded in the fiscal year 2016/17 financial statements.*

Following is a summary of the State System's balance sheet at June 30, 2018, 2017, and 2016.

(in millions)

Balance Sheet

	June 30, 2018	**Change from Prior Year**	**June 30, 2017**	**Change from Prior Year**	**June 30, 2016**	**Change from Prior Year**
Assets						
Cash and investments	$1,305.8	(4.4%)	$1,365.7	(0.8%)	$1,376.2	3.2%
Capital assets, net	1,920.4	1.1%	1,899.4	14.9%	1,653.3	4.0%
Other assets and deferred outflows	410.1	(3.5%)	424.8	12.8%	376.6	42.7%
Total assets and deferred outflows	$3,636.3	(1.5%)	$3,689.9	8.3%	$3,406.1	6.9%
Liabilities						
Workers' compensation	$22.4	9.8%	$20.4	(7.7%)	$22.1	(2.2%)
Compensated absences	126.2	5.6%	119.5	3.6%	115.4	0.7%
Net pension liability	937.8	(8.3%)	1,022.5	8.9%	938.6	17.5%
Net OPEB liability	2,324.6	103.0%	1,145.1	3.5%	1,106.6	4.5%
Bonds payable	1,035.6	(3.5%)	1,072.9	27.3%	842.6	5.3%
Other liabilities and deferred inflows	764.3	36.9%	558.4	11.1%	502.8	11.6%
Total liabilities and deferred inflows	5,210.9	32.3%	3,938.8	11.6%	3,528.1	8.7%
Net Position						
Net investment in capital assets	798.7	10.6%	722.4	1.8%	709.3	1.3%
Restricted	148.2	22.3%	121.3	6.0%	114.4	16.6%
Unrestricted	(2,521.5)	130.8%	(1,092.6)	15.5%	(945.7)	(10.4%)
Total net position	(1,574.6)	532.6%	(248.9)	104.0%	(122.0)	(108.5%)
Total liabilities, deferred inflows, and net position	$3,636.3	(1.5%)	$3,689.9	8.3%	$3,406.1	6.9%

Overall, **net position decreased by $1.326 billion** in fiscal year 2017/18. This compares to a decrease of $126.9 million in fiscal year 2016/17 from fiscal year 2015/16, and a decrease of $63.4 million in fiscal year 2015/16 from fiscal year 2014/15. The exceptionally large decrease in fiscal year 2017/18 is primarily the result of the implementation of GASB Statement No. 75, which alone caused net position to decrease by $1.280 billion over the prior year.

Revenues and Gains

Following is a summary of revenues and gains for the years ending June 30, 2018, 2017, and 2016.

(in millions)

Revenues and Gains

	June 30, 2018	Change from Prior Year	June 30, 2017	Change from Prior Year	June 30, 2016	Change from Prior Year
Operating revenues						
Tuition and fees, net	$850.5	(0.6%)	$855.7	2.0%	$839.0	2.7%
Grants and contracts	156.3	(1.1%)	158.1	1.7%	155.5	3.2%
Auxiliary enterprises, net	317.4	(3.2%)	327.8	1.4%	323.4	(0.2%)
Other	61.0	2.0%	59.8	29.7%	46.1	(12.4%)
Total operating revenues	1,385.2	(1.2%)	1,401.4	2.7%	1,364.0	1.5%
Nonoperating revenues and gains						
State appropriations	471.1	2.3%	460.3	2.5%	449.1	5.3%
Investment income, net	39.4	12.6%	35.0	45.8%	24.0	(22.6%)
Unrealized gain on investments	-	-	-	(100.0%)	2.6	-
Gifts, nonoperating grants, and other	187.0	8.3%	172.7	(7.5%)	186.7	6.9%
Total nonoperating revenues and gains	697.5	4.4%	668.0	0.8%	662.4	4.8%
Total revenues and gains	$2,082.7	0.6%	$2,069.4	2.1%	$2,026.4	2.6%

Overall, fiscal year 2017/18 **operating revenues** decreased by 1.2% from the prior fiscal year. Nonoperating revenues increased by 4.4%, for an overall increase in revenues and gains of 0.6%.

Tuition and fees are shown net of scholarship discounts and allowances and bad debt expense. In accordance with a formula prescribed by the National Association of College and University Business Officers (NACUBO), the State System allocates the cost of scholarships, waivers, and other student financial aid between scholarship discounts and allowances 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. Bad debt expense is an estimate of the amount owed by students that will not be collected.

With the decline in enrollment, overall net tuition and fee revenue decreased by $5.2 million, or 0.6%, from fiscal year 2016/17, compared to an increase of $16.7 million, or 2.0%, in fiscal year 2016/17 over fiscal year 2015/16. The fiscal year 2016/17 increase was attributed to a combination of the increase in tuition and fee rates and the newly implemented flexible tuition pricing programs at several universities.

Auxiliary enterprises revenue, which includes food service sales, housing fees, and fees for the operation, maintenance, debt service, and renewal of student union and recreation centers, decreased by $10.4 million, or 3.2%, from fiscal year 2016/17. This compares to an increase of $4.4 million in fiscal year 2016/17 over fiscal year 2015/16. The 2017/18 decrease can be attributed to declining enrollment, while the 2016/17 increase was due primarily to the additional revenue that some universities recorded from the housing operations that were newly acquired from their affiliates.

State appropriations include cash as well as capital appropriations that are received in the form of noncash furnishings and equipment for the Commonwealth-funded construction projects. The fiscal year 2017/18 general cash appropriation was $453.1 million, an $8.9 million increase over fiscal year 2016/17, while capital appropriations were

$18.0 million, a $1.9 million increase over fiscal year 2016/17.

Investment income (net of related investment expenses) for fiscal year 2017/18 was $39.4 million. This represents an increase of $4.4 million over fiscal year 2016/17, despite a decline of $59.8 million in cash and investments. The increase is due partly to rising interest rates during the fiscal year. Rates moved from a low of 1.20% in fiscal year 2016/17 to a high of 2.10% during fiscal year 2017/18. The overall average change in rates from fiscal year 2016/17 to fiscal year 2017/18 was an increase of 40 basis points, or 30.8%. Also contributing to the increase in investment income is $15.9 million of investment earnings in the reimbursement bond investment portfolio, which is dedicated to pay associated debt service.

Expenses and Losses
Following is a summary of expenses and losses for the years ending June 30, 2018, 2017, and 2016.

(in millions)

Expenses and Losses

	June 30, 2018	Change from Prior Year	June 30, 2017	Change from Prior Year	June 30, 2016	Change from Prior Year
Operating expenses						
Instruction	$755.6	(3.1%)	$779.8	4.1%	$749.3	1.3%
Research	7.3	14.1%	6.4	1.6%	6.3	8.6%
Public service	43.7	2.6%	42.5	7.9%	39.4	5.1%
Academic support	191.1	3.1%	185.4	0.8%	184.0	2.7%
Student services	190.3	0.4%	189.6	2.7%	184.7	2.0%
Institutional support	265.7	5.0%	253.0	(1.7%)	257.2	3.5%
Operations and maintenance of plant	162.0	1.7%	159.3	(0.4%)	159.9	4.2%
Depreciation	136.4	3.1%	132.3	8.7%	121.7	1.7%
Student aid	75.4	(1.3%)	76.4	(3.4%)	79.1	8.5%
Auxiliary enterprises	255.1	(1.5%)	259.0	2.0%	253.8	(0.7%)
Total operating expenses	2,082.6	(0.1%)	2,083.7	2.4%	2,035.4	2.1%
Other expenses and losses						
Interest expense on capital asset-related debt	37.1	(2.9%)	38.2	12.7%	33.9	(7.4%)
Loss on disposal/acquisition of assets	2.3	(95.8%)	54.8	167.3%	20.5	113.5%
Unrealized loss on investment	19.6	(0.5%)	19.7	-	-	-
Total other expenses and losses	59.0	(47.6%)	112.7	107.2%	54.4	(8.3%)
Total expenses and losses	$2,141.6	(2.5%)	$2,196.4	5.1%	$2,089.8	1.8%

Universities spent $755.6 million on **instruction**, or 36.3% of total operating expenses, in fiscal year 2017/18. This represents a decrease of $24.2 million, or 3.1%, over fiscal year 2016/17, the first decrease in spending on instruction since fiscal year 2011/12. University spending on instruction had been steadily rising for the last five years.

Financial aid to students in the form of grants, waivers, and scholarships was $308.6 million in fiscal year 2017/18. In accordance with a formula prescribed by the National Association of College and University Business Officers (NACUBO), in fiscal year 2017/18 the State System reported $232.7 million of financial aid as *discounts,* which are netted against tuition and fees, and $75.9 million as *student aid*, which is reported as an expense. Of these amounts, $2.2 million of discounts and $0.6 million of student aid expense were reported in Auxiliary enterprises.

Including the financial aid that is recorded as a discount against tuition and fees, financial aid increased in fiscal year 2017/18 by $8.7 million from the previous year. This is primarily because the universities granted an additional $9.3 million in tuition, housing, and dining waivers in fiscal year 2017/18. Federal Pell grants increased by $5.1 million, while Pennsylvania Higher Education Assistance Agency (PHEAA) grants decreased by $5.1 million over fiscal year 2016/17, and financial aid from all other sources decreased by $0.6 million. Following is the breakdown of financial aid in fiscal years 2017/18 and 2016/17.

(in millions)

Student Financial Aid

	2017/18	**2016/17**
Federal Pell grants	$139.3	$134.2
Other federal aid	5.5	5.7
State financial aid including PHEAA grants	86.3	91.4
Local government financial aid	0.3	0.4
Scholarships from endowments and restricted gifts and grants	17.7	18.1
Unrestricted scholarships and fellowships	11.7	11.6
Tuition and fee waivers	45.1	36.6
Housing and dining waivers	2.7	1.9
Total	$308.6	$299.9

Interest expense on capital asset-related debt was $37.1 million, a decrease of $1.1 million over fiscal year 2016/17. The decrease is due primarily to the State System's annual practice of refunding existing debt with debt that carries lower interest rates. Also offsetting debt increases is the faster amortization of the State System's older, more expensive, debt, as a higher ratio of debt service is applied to principal rather than interest in the later years of the payment schedules.

Salaries and benefits totaled $1.4 billion in fiscal year 2017/18. Salary and wage expenses increased by $5.5 million, or 0.6%, while benefits expenses decreased by $22.4 million, or 4.2%, over fiscal year 2016/17, for an overall decrease of $16.9 million. The decrease in benefits expenses was caused primarily by a $23.5 million decrease in the actuarially calculated pension and OPEB expense, which dropped due to improving interest rates, rather than to the contributions actually paid by the universities, which increased, as described in detail in the next sections. Following is a summary of salaries, wages, and benefits expenses for the years ending June 30, 2018, 2017, and 2016.

(in millions)

Salaries, Wages, and Benefits

	June 30, 2018	**Change from Prior Year**	**June 30, 2017**	**Change from Prior Year**	**June 30, 2016**	**Change from Prior Year**
Salaries and wages	$912.0	0.6%	$906.5	3.0%	$880.4	(1.3%)
Benefits						
Employee healthcare	128.2	(2.3%)	131.2	(4.3%)	137.1	5.2%
Pension benefits	183.5	(6.4%)	196.1	19.6%	163.9	21.6%
Retiree healthcare	98.8	(9.9%)	109.6	(12.3%)	125.0	4.8%
Other benefits	102.4	4.1%	98.4	1.2%	97.2	(2.5%)
Total benefits	512.9	(4.2%)	535.3	2.3%	523.2	8.1%
Total salaries, wages, and benefits	$1,424.9	(1.2%)	$1,441.8	2.7%	$1,403.6	2.0%

The $5.5 million increase in **salaries and wages** in fiscal year 2017/18 is the result of the salary increases granted in collective bargaining agreements, or directly authorized by the Board in the case of nonrepresented employees, partially offset by overall reductions in complement. Total permanent salaried complement, which excludes temporary and wage employees, decreased to 10,200 in fall 2017, compared to 10,343 in fall 2016 and 10,380 in fall 2015. The universities have reduced staff by 9.2%, or 1,029 employees, since fall 2008, when total permanent salaried complement was 11,229.

The employer share of **employee healthcare contributions** decreased 2.3% from fiscal year 2016/17, for a total decrease of $3.0 million. This follows a decrease of 4.3% ($5.9 million) in fiscal year 2016/17, and an increase of 5.2% ($6.8 million) in fiscal year 2015/16, over the prior fiscal years. The current year decrease can be attributed in part to a reduction in the number of employees receiving benefits, as well as design changes in the plan administered by the State System, which increased employees' share of expenses through higher employee premium contributions, copays, deductibles, and coinsurance. These reductions were partially offset, however, by a premium increase of 3.96%, or $1.3 million, in the plan administered by the PEBTF. The employer share of combined **retiree pension and healthcare contributions**, increased slightly over fiscal year 2016/17, for a total increase of $0.3 million. This follows an increase of 5.6% ($11.0 million) and an increase of 11.9% ($20.8 million) in fiscal years 2016/17 and 2015/16, respectively, over the prior fiscal years. Following is a summary of the State System's contributions for retiree pension and healthcare benefits for the years ending June 30, 2018, 2017, and 2016.

(in millions)

State System Employer Contributions for Retiree Pension and Healthcare Benefits

	June 30, 2018	Increase (Decrease) from Prior Year	June 30, 2017	Increase (Decrease) from Prior Year	June 30, 2016	Increase (Decrease) from Prior Year
Pension						
SERS	$94.7	13.1%	$83.8	21.3%	$69.0	20.6%
PSERS	8.0	10.9%	7.1	18.2%	6.0	14.8%
ARP	45.1	(0.5%)	45.3	3.2%	43.9	(1.5%)
Healthcare						
System Plan	37.7	(2.1%)	38.5	(2.8%)	39.6	7.3%
REHP	21.4	(32.7%)	31.9	(13.9%)	37.0	20.4%
PSERS Healthcare	0.2	1.1%	0.2	.7%	0.2	(9.0%)
Totals	$207.1	0.1%	$206.8	5.6%	$195.7	11.9%

- **Employer contributions to SERS**, a defined benefits pension plan, were 34.4% of a participating employee's salary for the vast majority of participants in fiscal year 2017/18. This rate has been steadily and significantly increasing since fiscal year 2010/11, when the rate was 4.11% of an employee's salary. The rate increases to 34.63% in fiscal year 2018/19, and is expected to remain at about the same rate for the near future. Approximately 40% of the State System's employees are enrolled in SERS.

- **Employer contributions to PSERS**, a defined benefits pension plan, were 15.87% of a participating employee's salary in fiscal year 2017/18. This rate also has been significantly increasing, with some fluctuation, since fiscal year 2010/11, when the rate was 2.82% of an employee's salary. The rate increases to 16.3% in fiscal year 2018/19, and is expected to remain at about the same rate for the near future. The Commonwealth makes annual pension contributions to PSERS on behalf of State System employees at the same annual rate. Since approximately only 7% of the State System's employees are enrolled in PSERS, the impact of contribution rate increases from PSERS is far less than the impact from SERS.

- **Employer contributions to the ARP**, a defined contribution plan, were 9.29% of a participating employee's salary in fiscal year 2017/18, the same rate since the plan's inception, and is expected to remain at the same rate for the near future. Approximately 49% of the State System's employees are enrolled in the ARP.

- **Employer contributions to the State System OPEB Plan**, a defined benefits retiree healthcare plan administered by the State System, are made to a third-party health insurance vendor based on claims estimates agreed to by the State System and the third-party vendor. The vendor charges an additional assessment or issues a cash refund in the following year to reconcile to the actual claims paid. Despite the increasing population of retirees and rising healthcare costs, the State System has seen flat or declining healthcare spending in this plan from retirees for the last several years. This can be attributed in part to design changes that increased retirees' share of expenses through higher employee premium contributions, copays, deductibles, and coinsurance. The rate for fiscal year 2017/18 was set at $188 per active participating employee per pay, compared to a rate of $175.25 in fiscal year 2010/11. The rate has been decreased to $184 in fiscal year 2018/19, but may be increased in future years, depending upon actual claims experience.

- **Employer contributions to the REHP**, a defined benefits retiree healthcare plan administered by the PEBTF, were $300 per active participating employee in the first half of fiscal year 2017/18, but dropped to $188 in the second half. The contribution rate is set at the discretion of the Commonwealth and periodically fluctuates, ranging from $200 in fiscal year 2010/11 to $418 in fiscal year 2015/16. The rate will be back to $300 in fiscal year 2018/19.

- **Employer contributions to the PSERS Health Insurance** Premium Assistance Program, a defined benefits retiree healthcare plan administered by PSERS, were 0.415% of a participating employee's salary in fiscal year 2017/18. The rate has been and is expected to remain at approximately the same amount. Any State System retiree who is a member of PSERS is eligible for this additional healthcare benefit, which offers up to $100 per month of reimbursements for healthcare costs, including insurance premiums.

The cost for **all other employee benefits**, such as Social Security and workers' compensation, increased by a total of $4.0 million, or 1.4%, over fiscal year 2016/17, compared to a fiscal year 2016/17 increase of $1.2 million, or 1.2%, over fiscal year 2015/16. The fiscal year 2017/18 increase can be attributed to the increase in salaries and wages, since these benefits are based on a percentage of salaries and wages.

Future Economic Factors

The **Commonwealth** ended fiscal year 2017/18 with $34.6 billion in General Fund collections, more than 9% higher than the previous year, resulting in a projected $22 million surplus. In June 2018, Governor Tom Wolf signed a fiscal year 2018/19 Commonwealth budget with a $32.7 billion spending plan that does not raise any broad-based taxes. The Commonwealth budget, which is highly dependent on a growing economy, faces the challenges of continually increasing pension obligations, wages and benefits, debt service, and medical and entitlement costs.

Moody's Investors Service, Inc., stated the following in its April 2018 Credit Opinion of the Commonwealth:

> *Pennsylvania's (Aa3 stable) below average state rating reflects its relatively high leverage and fixed cost burden, as well as lower than average job and revenue growth. Although the rating is below that of most states, the above challenges are balanced by the state's very large economic base, solid income statistics and sound financial position.*

System Redesign

The State System is undertaking a System Redesign, which began last year with a top-to-bottom review of the universities and the Office of the Chancellor. As a result of that review, the Board established three priorities:

- Ensuring student success;
- Leveraging university strengths; and
- Transforming the governance/leadership structure.

The Board also affirmed its commitment to ensuring the long-term sustainability of all 14 institutions within the System so that each may continue to serve students, its region, and the Commonwealth.

As part of the Redesign, a dozen new degree programs intended to be responsive to student and employer demand will be offered this fall under an accelerated degree approval process that shortens the time it takes for approval. Earlier this year, nine new degree programs were approved using the same process, bringing to 21 the total number of new programs approved since January 2018. During the same time, 15 degree programs have been placed in moratorium to ensure that all programs remain relevant.

Updated information on the System Redesign can be found at http://systemredesign.passhe.edu.

Leadership

As a result of a national search launched in fall 2017, Daniel Greenstein was selected as the next chancellor of the State System, effective September 4, 2018. For the past six years, Dr. Greenstein led the Postsecondary Success strategy at the Bill and Melinda Gates Foundation, and previously he was a top administrator in the University of California system. Dr. Greenstein has a bachelor's degree and a master's degree in history from the University of Pennsylvania, studied at the London School of Economics, and received his Ph.D. in social studies from Oxford University. Dr. Greenstein will lead the System Redesign effort with a commitment to the mission of providing accessible, affordable, quality higher education to students of all backgrounds while serving the needs of the Commonwealth.

Revenue
In fiscal year 2018/19, the State System will receive $468.1 million in **General Fund appropriations**, an increase of $15.0 million, or 3.3%, over fiscal year 2017/18. This compares to a 2.0% increase received in 2017/18 over the prior fiscal year. Over the last four years, the Commonwealth has restored about $55 million of the nearly $90 million in funding that was cut from the State System's annual appropriation at the beginning of the recession. During the same time, however, the System's mandated pension costs have increased by about $65 million, and other costs have risen as the result of inflation and other factors. Even with the four consecutive years of increases, the current year's appropriation is about the same as what the System received 12 years ago, in fiscal year 2006/07.

The Commonwealth has continued its commitment to fund the State System's capital needs through **both capital appropriations and deferred maintenance funds**. Annual capital appropriations are expected to increase from $65 to $70 million in fiscal year 2018/19, with the additional $5 million intended to fund demolition projects. The State System has received a $16.7 million Realty Transfer Tax allocation from the Key '93 funds in fiscal year 2018/19. This is a decrease of 7.2% from the $18.0 million received in fiscal year 2016/17, but adjustments in the amount received sometimes occur later in the year based on the real estate sales transactions within the Commonwealth during the fiscal year.

In July 2018 the Board approved a 2.99% **tuition increase** for the 2018/19 academic year, the second smallest tuition increase in more than a decade. The small increase was possible largely because of a fourth consecutive year of increased state funding, combined with expected healthcare and energy cost savings. Even with the increase, the State System universities will remain the **lowest-cost option** among all four-year colleges and universities in the state, and less than half the amount charged by most others. The $112-per-semester increase sets the base tuition rate for most full-time Pennsylvania residents—who comprise about 90% of all State System university students—at $3,858 per term, or $7,716 for the full year.

Nonresident, undergraduate tuition will increase by 2.99% beginning in fall 2018, ranging from $11,574 to $19,290 for the 2018/19 academic year. The resident, **graduate tuition** rate will be $516 per credit, an increase of $16. The typical nonresident, graduate tuition rate will increase by $24 per credit, to $774. The **technology tuition fee** will be $478 for full-time in-state students, and $728 for full-time out-of-state students.

The above increases, coupled with the 3.3% increase in state appropriations, will help offset mandatory cost increases across the System, but an **additional $20 million in budget reductions** by the universities still will be necessary. Significant cost increases in salaries are expected this year as a result of collective bargaining agreements but will be partially offset by a projected decrease in healthcare expenditures. The universities already have reduced expenditures by a combined nearly $360 million over the last dozen years in order to balance their budgets and help hold down student costs.

Performance Funding
Fiscal year 2017/18 is the last year of the current model of the State System's performance funding program, which was begun in 2011. In January 2018, the Board approved a transitional model built upon the System's historical performance funding concepts and most recent plan design, allocating **$39.1 million** in performance funding for fiscal year 2018/19, the same amount that was allocated in fiscal year 2017/18. It is expected that a new, longer-term funding program will be developed in the near future to better align with System Redesign and new System priorities, and that the continued development of performance funding will be part of the upcoming comprehensive review of the System's allocation of state resources.

Enrollment
With an undergraduate population comprising approximately 90% Pennsylvania residents—and the majority of those being traditional-age students enrolling right out of high school—the State System's enrollment historically has been closely tied to the state's high school demographic trends. As the number of high school graduates in the state continues to drop, most of the universities are expecting their enrollments to decline slightly, resulting in reduced revenue. In its April 2018 Credit Opinion of the Commonwealth, Moody's Investors Service, Inc., notes that Pennsylvania's population growth is the seventh slowest of the 50 states, and that it has the seventh oldest population of the 50 states, measured by the share of residents aged

55 or older. Following is the projected number of Pennsylvania **high school graduates** based on estimates from the Pennsylvania Department of Education.

Projected Pennsylvania High School Graduates		
Fiscal Year	**Number of Graduates**	**% Increase (Decrease)**
2018/19	123,982	(1.2%)
2019/20	121,210	(2.2%)
2020/21	122,183	0.8%
2021/22	122,950	0.6%
2022/23	121,152	(1.5%)
2023/24	122,657	1.2%
2024/25	124,448	1.5%
2025/26	124,200	(0.2%)

Cash Flow

The universities record their share of the State System pooled deposits and investments account at cost; that is, without regard to the fair value of the underlying investments. The associated markup or markdown for the fair value, as well as the annual unrealized gains or losses on investments, are recorded only at the consolidated level. In fiscal year 2017/18, the unrealized loss on the State System pooled deposits and investments account was $23.6 million, while the accumulated fair value markup at June 30, 2018, was $68.8 million. This compares to an unrealized loss on investments in fiscal year 2016/17 of $26.1 million and an accumulated fair value markup of $92.4 million at June 30, 2017. The fiscal year 2017/18 unrealized loss was a result of the rise in interest rates during the year, which caused the prices of fixed-income securities to decline from the prior fiscal year. It is important to note that the strategy of the investment portfolio is to buy quality investments and hold to maturity; therefore, unrealized gains and losses will not be realized.

The combination of factors such as years of stagnant appropriations, declining enrollment, low interest rates, increasing personnel costs, and high long-term debt continues to cause cash flow pressures for some State System universities. Overall operating cash decreased by $41.6 million, or 3.5% in fiscal year 2017/18, to $1.16 billion, compared to a balance of $1.20 billion at June 30, 2017. Cash flow weaknesses, which can seriously challenge financial viability, have more significantly affected the smaller State System universities, especially during the summer months between spring and fall tuition collections. The larger universities are better able to absorb declines in cash balances, and their cash positions remain relatively strong.

- **Cheyney University's cash flow** has been further stressed by the federal Department of Education's (ED) unwillingness to transfer $9.6 million in federal student financial aid funds from fiscal year 2017/18, $2.4 million from fiscal year 2016/17, and $380,000 from fiscal year 2015/16. The ED has released no funds to Cheyney since April 2018, and this protracted delay in the receipt of student financial aid funds is causing further pressure on the university's severe cash shortage.

  To meet Cheyney's biweekly payroll cash needs, the Office of the Chancellor has been issuing interest-free short-term appropriation anticipation notes to Cheyney, which are paid back as the monthly appropriations are received. In addition, in spring 2018, the Office of the Chancellor issued a $6.5 million loan, which, along with the $1.5 million interest-free loan issued in June 2017, are intended to be paid back when the funds are received from the ED. In April 2018, the Office of the Chancellor gave Cheyney a $200,817 loan to repair flood damage, which is to be paid back when anticipated insurance proceeds are received.

  In addition, over the last four years, Cheyney has borrowed a total of $30.5 million from the State System pooled deposits and investments account. The university's E&G and Auxiliary cash both would be in deficits without these borrowed funds. As detailed later in this document, in August 2017, the Board of Governors approved an action to forgive the $30.5 million owed by Cheyney University to the other 13 universities, provided that Cheyney meets certain fiscal conditions over the next four years. Assuming the conditions are met, the cash will be transferred from the other 13 universities over the next four years. This will cause additional cash flow stress to the other universities, especially to those that have relatively low cash balances.

  To ensure the security of the cash inflows to Cheyney that have been restricted as to purpose by the donor or grantor, separate bank and investment accounts have been established for these funds, and access to them requires the approval of the Office of the Chancellor. The university continues to reduce expenditures and is seeking alternative sources of revenue in an effort to stabilize its cash flow and balance its budget.

- **Clarion University's cash** has stabilized. Clarion's combined E&G and Auxiliary cash and investments increased by 5.9%, or $0.8 million, in fiscal year 2017/18 over fiscal year 2016/17. Since June 30, 2014, Clarion's unrestricted cash and investments have decreased by 60.6%, or $21.7 million, from $35.9 million at June 30, 2014, to $14.1 million at June 30, 2018. The Office of the Chancellor continues to work with Clarion University to monitor its cash flows.

- Despite significant efforts to reduce staff and engage in other cost-cutting measures, as well as new tuition pricing strategies begun in fiscal year 2016/17, **Mansfield University's** combined E&G and Auxiliary cash and investments have again experienced a relatively significant decline. Unrestricted balances decreased by $2.4 million to $14.4 million in fiscal year 2017/18, compared to $16.8 million at June 30, 2017. Since June 30, 2014, Mansfield's unrestricted cash and investments have decreased by 38.5%, or $9.0 million, from $23.4 million at June 30, 2014, to $14.4 million at June 30, 2018. The Office of the Chancellor continues to work with Mansfield University to closely monitor its cash flows.

- The remaining universities have **relatively stronger cash balances**, although some have experienced sharp fiscal year decreases in unrestricted cash, while a few have increased cash. California University's unrestricted cash balance, which had dropped to $19.1 million at June 30, 2015, has now increased to $40.6 million at June 30, 2018. Several universities have cash and investment balances close to or exceeding $100 million at June 30, 2018, with West Chester University having an unrestricted cash and investment balance of more than $216 million. Overall, university E&G cash and investments increased by $15.4 million in fiscal year 2017/18, to a balance of $705.8 million at June 30, 2018. Auxiliary cash and investments, however, decreased by $43.1 million in fiscal year 2017/18, for a balance of $283.4 million at June 30, 2018. This compares to an increase of $31.4 million in E&G cash and investments and a decrease of $10.4 million in Auxiliary cash and investments in fiscal year 2016/17 over fiscal year 2015/16. The Office of the Chancellor is monitoring universities whose cash balance, revenue, expenditure, and enrollment trends may be an indication of future cash flow weaknesses.

Compensation Costs

In January 2018, the Board approved a one-year collective bargaining agreement with **APSCUF** that runs from July 1, 2018, through June 30, 2019. Under the terms of the agreement, faculty received a salary increase of either 2.5% or 5%, depending on their pay level, effective the first pay of the 2018 fall semester, and they will receive an additional 2.5% general pay increase effective at the start of the spring 2019 semester.

All collective bargaining agreements will expire June 30, 2019, except for the agreement with the Security Police and Fire Professionals of America (SPFPA), which expires August 31, 2020.

The Board has not approved any future merit increases for employees not represented by a union.

Energy Costs

Energy costs are expected to decrease in fiscal year 2018/19 by about $2.4 million. Since fiscal year 2005/06, the universities have avoided about $250 million in energy costs through the completion of a variety of energy conservation projects that have made campus facilities more efficient, and lower rates have been achieved through System-wide procurement. The savings resulting from those avoided costs continue to accumulate at a rate of more than $20 million a year.

Shared Services

The universities have generated millions more in cost savings by sharing a variety of services, including payroll, labor relations, human resources, construction support, legal services, and library resources, which otherwise would require massive duplication at each institution. The System manages more than 70 strategically sourced contracts, participates in numerous procurement co-ops, and utilizes state and local governmental contracts and pricing to produce additional savings.

Debt Refunding

The Tax Cuts and Job Act that was signed on December 22, 2017, included legislation to eliminate tax-exempt advance refunding of tax-exempt bonds after December 31, 2017. Over the past ten years, the State System has saved in excess of $30.6 million by taking advantage of lower interest rates through tax-exempt advanced refundings, but this strategy for reducing the cost of debt no longer will be an option for the State System.

Cheyney University

As further detailed in the disclosures attached to these financial statements under note 13, *Contingencies and Commitments*, Cheyney University's accreditation status was placed on probation by the Middle States Commission on Higher Education (Middle States) in November 2015. The university was given two years to address the deficiencies noted by Middle States. In June 2017, Middle States required Cheyney to show cause as to why its accreditation should not be withdrawn, and Cheyney submitted the required documentation. In November 2017, Middle States extended Cheyney's accreditation for an additional year, noting that Cheyney had made "significant progress toward the resolution of its non-compliance issues" and is "making a good-faith effort to remedy existing deficiencies." Middle States further stated that there is "a reasonable expectation that such deficiencies will be remedied within the period of the extension" of the university's accreditation. In September 2018, Cheyney submitted a report to Middle States demonstrating its progress on the remaining accreditation issues, and a response from Middle States as to whether or not Cheyney's accreditation will be further extended is expected in November 2018.

To help the university secure continued accreditation, in August 2017, the Board approved a motion that, if over the next four years the university demonstrates fiscal stability, the more than $30 million in loans made to Cheyney from the 13 other universities and the Office of the Chancellor will be forgiven. One-third will be forgiven when Cheyney cuts $7.5 million from its fiscal year 2017/18 budget and maintains a balanced budget for fiscal year 2018/19. The next two-thirds will be forgiven when Cheyney demonstrates a balanced budget in each of the following two fiscal years. Cheyney has advised the Board that is has successfully met the first criteria of cutting $7.5 million dollars from its fiscal year 2017/18 budget when the expenditure cuts are viewed on an annualized basis.

The university continues to make cuts to administration and staff and reorganize business and campus operations and has placed some academic programs into moratorium to additionally help balance the budget and better align academic programs with the future of the university.
As also detailed in note 13, in August 2015, Cheyney University voluntarily self-reported to the U.S. Department of Education (ED) that $29.6 million of federal student financial aid was improperly administered and delivered in fiscal years 2011/12, 2012/13, and 2013/14, covering almost 4,400 student records. The State System has been under continual review with the ED since reporting these findings. The ED is requiring the university to take specified corrective actions, including submitting file reviews, reconciliations, and updated policies and procedures, and further requires that Cheyney engage an independent Certified Public Accountant to attest to the file reviews and reconciliations.

One consequence of the university's past deficiencies in administering federal student aid is that in September 2015 the ED placed the university on Heightened Cash Monitoring 2 (HCM2) status, meaning that the university does not receive federal student financial aid funds in advance, but must use its own cash to grant federal financial aid to its students and then request reimbursement from the ED. After demonstrating compliance with HCM2 requirements, the university has begun to slowly receive its funds, but only after providing extensive detailed documentation for nearly every student's financial aid awards. As previously mentioned, at June 30, 2018, Cheyney was awaiting receipt of $12.4 million in federal student financial aid funds from fiscal years 2015/16, 2016/17, and 2017/18.

In January 2016, the U.S. Department of Justice (DOJ) notified the State System that it was investigating the application and use of federal student financial aid by Cheyney University and the oversight of the university by the State System. The DOJ requested that the university and State System preserve and produce certain documents. The State System has fully complied with the DOJ's request. No action has been taken at this point by the DOJ, and the possible resulting outcomes from the investigation are uncertain until communication is received from the DOJ.

Despite unrestricted revenues increasing slightly, and unrestricted expenditures decreasing by $2.6 million, Cheyney University ended fiscal year 2017/18 with a $3.2 million loss in E&G activity and a $1.4 million loss in Auxiliary activity, for a total unrestricted loss of $4.6 million, bringing the university's unrestricted net position deficit to $29.6 million at June 30, 2018 (excluding unfunded pension, OPEB, and compensated absences liabilities). This follows a $7.4 million loss in unrestricted funds in fiscal year 2016/17, a $5.7 million loss in unrestricted funds in fiscal year 2015/16, a $5.5 million loss in unrestricted funds in fiscal year 2014/15, and a $4.2 million loss in fiscal year 2013/14.

Cheyney's fall 2018 headcount enrollment is less than 500, significantly lower than its fall 2017 enrollment of 755. For comparison, Cheyney's enrollment was 746 students in fall 2016 and 711 students in fall 2015.

The State System, through the Office of the Chancellor, continues to provide oversight to Cheyney's leadership in an attempt to stabilize its financial condition and implement a comprehensive plan that includes timely and accurate financial aid processing, increasing student enrollment, revitalizing its academic program array, and right-sizing personnel and facilities.

Rating Agencies

In August 2018, **Fitch Ratings, Inc.**, assigned an A+ rating to the State System's Series AV bonds, and downgraded the rating on the State System's remaining portfolio of outstanding bonds from AA- to A+, but revised the outlook from *negative* to *stable*. Fitch cited as the primary rating driver for the downgrade the State System's "continued erosion in enrollment, which is expected to persist as demographic and economic challenges across [the State System's] broad reach continue." Fitch also attributed the rating to continually weakened operations for the past five fiscal years, which they project will persist through fiscal year 2019, though with "steadier, rather than worsening results." Fitch notes that the State System's available fund levels are solid and have remained healthy, and that the debt burden remains manageable.

In its August 13, 2018, *Credit Opinion*, **Moody's Investors Service, Inc.**, reaffirmed the State System's bond rating of Aa3, and revised the outlook from *negative* to *stable*. Moody's notes:

> *The system has regularly demonstrated an ability to adjust operations to align with continued enrollment declines. [The State System] has strong unrestricted liquidity and good reserves providing operating flexibility as it works to adjust its expense base. A significant expense constraint is that nearly all of its faculty and staff are subject to collective bargaining agreements that are regularly negotiated. This exposes the system to both rising compensation costs and potential work stoppages. Although it has high leverage, [the State System] has manageable debt plans coupled with a fairly rapid debt amortization that should at least maintain debt levels.*

Moody's notes as the State System's challenges: continued cost containment efforts critical to sustaining credit quality in the face of declining enrollment; financial flexibility constrained by collective bargaining agreements and required pension and OPEB contributions; potential challenges in executing recommendations from System strategic review, and high leverage, with $2.3 billion of total debt when the debt of affiliates' student housing is included. Moody's notes as the State System's strengths: its substantial balance sheet reserves; its significant scale as one of the nation's largest higher education systems; effective System governance and management, including strong fiscal oversight and debt management, with System Redesign underway; good, although thinning cash flow; and modest near-term debt plans with significant principal repayment expected.

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

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Pennsylvania's State System of Higher Education

Balance Sheet

(dollars in thousands)

Assets and Deferred Outflows of Resources

	June 30, 2018	June 30, 2017
Current Assets		
Cash and cash equivalents	$ 44,017	$ 17,829
Short-term investments	588,029	680,955
Accounts receivable, students, net of allowance for doubtful accounts of $37,302 in 2018 and $34,067 in 2017	45,413	44,446
Accounts receivable, other	29,324	30,178
Governmental grants and contracts receivable	19,095	23,194
Prepaid expenses	13,599	12,732
Current portion of loans receivable, net	8,969	9,032
Due from component units	15,058	16,676
Other current assets	7,266	5,574
Total Current Assets	770,770	840,616
Noncurrent Assets		
Restricted cash and cash equivalents	25	25
Long-term investments, including endowments	673,748	666,842
Beneficial interests	23,493	-
Loans receivable, net	31,145	31,810
Due from component units	946	8,767
Capital assets, net of accumulated depreciation	1,920,448	1,899,382
Other noncurrent assets	1,300	1,371
Total Noncurrent Assets	2,651,105	2,608,197
Total Assets	3,421,875	3,448,813
Deferred Outflows of Resources	214,403	241,108
Total Assets and Deferred Outflows of Resources	$ 3,636,278	$ 3,689,921

See accompanying notes to financial statements.

Pennsylvania's State System of Higher Education

Balance Sheet *(continued)*
(dollars in thousands)

Liabilities, Deferred Inflows of Resources, and Net Position

	June 30, 2018	June 30, 2017
Current Liabilities		
Accounts payable and accrued expenses	$ 173,522	$ 176,567
Unearned revenue	49,959	51,139
Deposits	5,717	6,571
Current portion of workers' compensation liability	4,630	4,305
Current portion of compensated absences liability	11,401	10,620
Current portion of OPEB liability	59,098	-
Current portion of capitalized lease obligations	4,075	3,778
Current portion of bonds payable	74,270	70,605
Due to component units	11,894	10,490
Other current liabilities	113,541	117,144
Total Current Liabilities	508,107	451,219
Noncurrent Liabilities		
Unearned revenue	2,030	3,175
Workers' compensation liability, net of current portion	17,818	16,062
Compensated absences liability, net of current portion	114,800	108,906
Net pension liability	937,757	1,022,458
OPEB liability, net of current portion	2,265,515	1,145,088
Capitalized lease obligations, net of current portion	39,173	42,528
Bonds payable, net of current portion	961,300	1,002,310
Other noncurrent liabilities	94,998	99,826
Total Noncurrent Liabilities	4,433,391	3,440,353
Total Liabilities	4,941,498	3,891,572
Deferred Inflows of Resources	269,383	47,274
Net Position		
Net investment in capital assets	798,665	722,365
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	55,200	37,361
Student loans	5,050	5,345
Other	3,249	3,272
Expendable:		
Scholarships and fellowships	29,599	26,153
Capital projects	37,405	32,847
Other	17,765	16,292
Unrestricted	(2,521,536)	(1,092,560)
Total Net Position	(1,574,603)	(248,925)
Total Liabilities, Deferred Inflows of Resources, and Net Position	$ 3,636,278	$ 3,689,921

See accompanying notes to financial statements.

Pennsylvania's State System of Higher Education

Statement of Revenues, Expenses, and Changes in Net Position
For the Years Ended June 30, 2018 and 2017
(dollars in thousands)

	2018		2017	
Operating Revenues				
Tuition and fees	$ 1,089,509		$ 1,086,337	
Less discounts and allowances	(239,014)		(230,636)	
Net tuition and fees		$ 850,495		$ 855,701
Grants and contracts		156,285		158,108
Sales and services		41,717		39,968
Auxiliary enterprises, net of discounts of $1,516 in 2018 and $2,450 in 2017		317,398		327,781
Other revenues, net		19,322		19,849
Total Operating Revenues		1,385,217		1,401,407
Operating Expenses				
Instruction		755,638		779,814
Research		7,339		6,353
Public service		43,644		42,543
Academic support		191,062		185,411
Student services		190,322		189,610
Institutional support		265,714		253,007
Operations and maintenance of plant		162,005		159,295
Depreciation		136,422		132,267
Student aid		75,369		76,416
Auxiliary enterprises		255,111		258,970
Total Operating Expenses		2,082,626		2,083,686
Operating Loss		(697,409)		(682,279)
Nonoperating Revenues (Expenses)				
State appropriations, general and restricted		453,108		444,224
Pell grants		139,304		134,162
Investment income, net of related investment expense of $370 in 2018 and $333 in 2017		39,367		35,035
Unrealized gain (loss) on investments		(19,595)		(19,704)
Gifts for other than capital purposes		21,300		20,877
Interest expense on capital asset-related debt		(37,105)		(38,228)
Loss on disposal/acquisition of assets		(2,267)		(54,820)
Other nonoperating revenue		11,279		12,125
Net Nonoperating Revenues		605,391		533,671
Loss before other revenues		(92,018)		(148,608)
State appropriations, capital		18,023		16,081
Capital gifts and grants		15,121		5,584
Decrease in Net Position		(58,874)		(126,943)
Net position—beginning of year		(248,925)		(121,982)
Restatement for July 1, 2017, OPEB liabilities and related expenses		(1,280,301)		
Restatement for July 1, 2017, beneficial interests		13,497		
Net position—beginning of year, restated		(1,515,729)		
Net position—end of year		$ (1,574,603)		$ (248,925)

See accompanying notes to financial statements.

Pennsylvania's State System of Higher Education

Statement of Cash Flows
For the Years Ended June 30, 2018 and 2017
(dollars in thousands)

	2018	2017
Cash Flows from Operating Activities		
Tuition and fees	$ 848,577	$ 852,254
Grants and contracts	160,206	152,507
Payments to suppliers for goods and services	(486,334)	(471,080)
Payments to employees	(1,339,840)	(1,331,148)
Loans issued to students	(5,328)	(5,462)
Loans collected from students	6,054	5,726
Student aid	(75,935)	(76,910)
Auxiliary enterprise charges	315,836	325,798
Sales and services	41,119	41,059
Other receipts	39,268	66,846
Net cash used in operating activities	(496,377)	(440,410)
Cash Flows from Noncapital Financing Activities		
State appropriations	453,108	444,224
Gifts and nonoperating grants for other than capital purposes	160,327	154,847
PLUS, Stafford, and other loans receipts (non-Perkins)	908,840	919,357
PLUS, Stafford, and other loans disbursements (non-Perkins)	(909,075)	(919,385)
Agency transactions, net	4,190	(1,570)
Other	1,279	2,104
Net cash provided by noncapital financing activities	618,669	599,577
Cash Flows from Capital Financing Activities		
Proceeds from capital debt and leases	140,916	86,534
Capital appropriations	18,023	15,511
Capital grants and gifts received	11,840	4,751
Proceeds from sales of capital assets	61	90
Purchases of capital assets	(149,390)	(173,783)
Principal paid on capital debt and leases	(169,461)	(71,488)
Interest paid on capital debt and leases	(49,851)	(46,567)
Net cash used in capital financing activities	(197,862)	(184,952)
Cash Flows from Investing Activities		
Proceeds from sales and maturities of investments	31,642,468	34,702,266
Interest on investments	38,549	34,654
Purchase of investments	(31,579,257)	(34,713,825)
Net cash provided by (used in) investing activities	101,760	23,095
Net Increase (Decrease) in Cash and Cash Equivalents	26,188	(2,690)
Cash and cash equivalents—beginning of year	17,854	20,544
Cash and cash equivalents—end of year	$ 44,042	$ 17,854

See accompanying notes to financial statements.

Pennsylvania's State System of Higher Education

Statement of Cash Flows *(continued)*
For the Years Ended June 30, 2018 and 2017
(dollars in thousands)

	2018	2017
Reconciliation of Operating Loss to Net Cash Used in Operating Activities		
Operating loss	$ (697,409)	$ (682,279)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	136,422	132,267
Expenses paid by Commonwealth or donor	7,251	6,532
Effect of changes in operating assets and liabilities:		
Receivables, net	2,212	(6,547)
Other assets	3,060	8,944
Accounts payable	(6,502)	983
Unearned revenue	(2,222)	(601)
Student deposits	(854)	504
Compensated absences	6,675	4,103
Loans to students and employees	726	264
Defined benefit pensions	(84,702)	83,821
Other postemployment benefits liability (OPEB)	(100,775)	38,445
Other liabilities	(10,153)	7,084
Deferred outflows of resources related to pensions	86,962	(51,180)
Deferred outflows of resources related to OPEB	(59,306)	-
Deferred inflows of resources related to pensions	23,534	17,250
Deferred inflows of resources related to OPEB	198,704	-
Net cash used in operating activities	$ (496,377)	$ (440,410)
Noncash Activities		
Capital assets included in payables	$ 6,166	$ 13,761
Capital assets acquired by new capital leases	797	1,348
Capital assets acquired by gift or appropriation	3,464	1,309
Student housing capital assets acquired	-	191,829
Like-kind exchanges	1	22
Debt acquired for student housing acquisition	-	243,090

See accompanying notes to financial statements.

Pennsylvania’s State System of Higher Education

Component Units Statement of Financial Position

(dollars in thousands)

	June 30, 2018	June 30, 2017
Assets		
Cash and cash equivalents	$ 160,515	$ 155,724
Accounts receivable	20,408	7,544
Contributions/pledges receivable	18,349	16,978
Due from universities	11,692	10,756
Prepaid expenses	2,339	2,641
Inventories	6,000	6,098
Short-term investments	63,417	60,685
Investments	459,532	440,646
Capital assets:		
Land	34,393	33,072
Buildings	1,222,725	1,167,813
Building improvements	20,139	19,140
Improvements other than buildings	7,481	7,344
Equipment and furnishings	72,125	72,170
Construction in progress	7,541	40,906
	1,364,404	1,340,445
Less accumulated depreciation	(301,158)	(270,679)
Capital assets, net	1,063,246	1,069,766
Other assets	125,394	121,182
Total Assets	$ 1,930,892	$ 1,892,020
Liabilities		
Accounts payable and accrued expenses	$ 31,236	$ 29,443
Deferred revenue	22,568	10,030
Interest payable	7,856	8,779
Annuity liabilities	6,706	7,140
Due to universities	15,445	24,973
Deposits payable	27,991	25,806
Interest rate swap agreements	42,910	58,565
Capitalized leases	27,554	28,662
Bonds payable	901,934	913,142
Notes payable	318,474	319,078
Other liabilities	12,615	16,392
Total Liabilities	1,415,289	1,442,010
Net Assets		
Unrestricted	102,571	58,516
Temporarily restricted	117,129	114,750
Permanently restricted	295,903	276,744
Total Net Assets	515,603	450,010
Total Liabilities and Net Assets	$ 1,930,892	$ 1,892,020

See accompanying notes to financial statements.

Pennsylvania's State System of Higher Education

Component Units Statement of Activities
For the Years Ended June 30, 2018 and 2017
(dollars in thousands)

	2018	2017
Revenues and Gains		
Contributions	$ 48,070	$ 43,946
Sales and services	43,317	45,122
Student fees	33,902	33,188
Grants and contracts	10,010	10,843
Rental income	152,405	149,294
Investment income, gains, and losses	51,971	69,155
Other revenues and gains	22,830	68,937
Total Revenues and Gains	362,505	420,485
Expenses and Losses		
Program services:		
Scholarships and grants	17,160	17,211
Student activities and programs	27,627	27,882
University stores	24,368	26,983
Housing	134,207	142,417
Other university support	25,227	15,486
Other programs	21,156	24,492
Management and general	32,891	32,577
Fundraising	11,308	10,701
Other expenses and losses	2,968	5,990
Total Expenses and Losses	296,912	303,739
Change in Net Assets	65,593	116,746
Net assets—beginning of year	450,010	333,264
Net assets—end of year	$ 515,603	$ 450,010

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

Years Ended June 30, 2018 and 2017

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Pennsylvania's State System of Higher Education (State System) 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). The State System 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. The State System comprises the 14 universities and the Office of the Chancellor.

Reporting Entity

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

Certain affiliated organizations are included in the State System'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 the State System 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 the State System, the activity of the organization is significant to the State System universities, and the State System historically has received a majority of these economic resources. Neither the State System nor its universities control the timing or amount of receipts from these organizations.

The State System 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 (GAAP), 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
The State System 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 and extraordinary expenses, are recorded as operating expenses. Appropriations, gifts, investment income, parking and library fines, capital grants, gains and losses on investments, gains and losses on the acquisition and disposal of assets, 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.

Deferred Outflows and Deferred Inflows of Resources
The balance sheet reports separate sections for *Deferred Outflows of Resources* and *Deferred Inflows of Resources*.

Deferred Outflows of Resources, reported after *Total Assets,* is defined by GASB as a consumption of net position that applies to future periods. The expense is recognized in the applicable future period(s). *Deferred Inflows of Resources,* reported after *Total Liabilities,* is defined by GASB as an acquisition of net position that applies to future periods. The revenue is recognized in the applicable future period(s).

Transactions are classified as deferred outflows of resources or deferred inflows of resources only when specifically prescribed by GASB standards.

The State System is required to report the following as Deferred Outflows of Resources or Deferred Inflows of Resources.

- Deferred gain or loss on bond refundings, which results when the carrying value of a refunded bond is greater or less than its reacquisition price. The difference is deferred and amortized over the remaining life of the old bond or the life of the new bond, whichever is shorter.
- For defined benefit pension plans and other postemployment benefit (OPEB) plans: the difference between expected (actuarial) and actual experience, changes in actuarial assumptions, the net difference between projected (actuarial) and actual earnings on pension and OPEB plan investments, changes in the State System's proportion of expenses and liabilities to the pension and OPEB plans as a whole, differences between the State System's pension and OPEB contributions and its proportionate share of contributions, and State System pension and OPEB contributions subsequent to the respective pension or OPEB plan valuation measurement date.

Net Position
Net position is the residual of Assets, plus Deferred Outflows of Resources, less Liabilities, less Deferred Inflows of Resources. The State System maintains the following classifications of net position.

Net investment in capital assets: 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 the State System 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 the State System 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
The State System 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. The State System 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 the State System. Since the State System 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 on a composite basis in the year of purchase. 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. The State System 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.

The State System 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, 2018 and 2017.

Unearned 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.

Compensated Absences
The estimated cost of future payouts of annual leave and sick leave that employees have earned for services rendered, and which the employees may be entitled to receive upon termination or retirement, is recorded as a liability.

Pension Plans and OPEB Plans
Eligible employees of the State System enroll in one of three available pension plans immediately upon employment. The State System also offers healthcare and tuition benefits to eligible employees upon employment, which vary depending upon the employee's labor group.

Scholarships and Waivers
In accordance with a formula prescribed by the National Association of College and University Business Officers (NACUBO), the State System allocates the cost of scholarships, waivers, and other student financial aid between *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
The State System 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.

Reclassifications
Certain amounts in the prior period presented have been reclassified to conform to the current period financial statement presentation. These reclassifications have no effect on the previously reported net position or changes therein.

New Accounting Standards
The State System has implemented GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. Statement No. 75 requires the State System to report its share of the liabilities, expense, deferred outflows of resources, and deferred inflows of resources allocated to it by the Retired Employees Health Program and the Public School Employees' Retirement System Health Insurance Premium Assistance Program, both of which are defined benefit retiree healthcare plans administered by the Commonwealth of Pennsylvania. Statement No. 75 also has significantly increased the liability that the State System records for the defined benefit retiree healthcare and tuition benefits plan that the State System administers, and requires the recording of deferred outflows of resources and deferred inflows of resources associated with the plan. The July 1, 2017, balances of these other postemployment benefit liabilities (with "other" meaning "other than pensions"), known as OPEB liabilities, and related deferred outflows of resources and deferred inflows of resources, are reported in the Statement of Revenues, Expenses, and Changes in Net Position as a restatement to the *2017 Net position—beginning of year*. The plans did not provide sufficient information to restate the June 30, 2017, financial statements.

In addition, the State System has implemented GASB Statement No. 81, *Irrevocable Split-Interest Agreements*. Under Statement No. 81, the State System is reporting as beneficial interests, along with the associated deferred inflows of resources, the value of irrevocable split-interest agreements held by a third party of which the university is the beneficiary. The State System also is reporting as beneficial interests the value of funds held in perpetual trusts by third parties of which the university is the beneficiary. The July 1, 2017, balances of these beneficial interests and related deferred inflows of resources are reported in the Statement of Revenues, Expenses, and Changes in Net Position as a restatement to the *2017 Net position—beginning of year*.

(in thousands)	**2017**
Net position—beginning of year, as previously stated	($248,925)
July 1, 2017, balance of the OPEB liabilities and related deferred outflows of resources and deferred inflows of resources	(1,280,301)
July 1, 2017, balance of the beneficial interests and related deferred inflows of resources	13,497
Net position—beginning of year, restated	($1,515,729)

GASB has issued several accounting standards that are required to be adopted by the State System in future years. The State System is evaluating the impact of the adoption of these standards on its financial statements as discussed below.

In June 2017, GASB issued Statement No. 87, *Leases.* Statement No. 87 establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. In other words, most leases currently classified as operating leases will be accounted for and reported in a similar manner as capital leases, with assets and liabilities recorded at lease inception. The State System has determined that the effect on net position and results of operations will be immaterial. The provisions in Statement No. 87 are effective for reporting periods beginning after December 15, 2019.

In March 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements.* Statement No. 88 is intended to improve the information that is disclosed in notes to government financial statements related to debt. The State System has determined that Statement No. 88 will have no effect on its financial statements.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period.* Statement No. 89 requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred, and should no longer be capitalized as part of the cost of an asset. The State System has determined that the effect of Statement No. 89 on its financial statements will vary from year to year, depending upon the amount of new debt incurred for capital assets. The provisions of Statement No. 89 are effective for reporting periods beginning after December 15, 2019.

In August 2018, GASB issued Statement No. 90, *Majority Equity Interests.* Statement No. 90 is intended to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. The State System has determined that Statement No. 90 will have no effect on its financial statements.

(2) Deposits and Investments

On June 30, 2018 and 2017, the carrying amount of the State System's demand and time deposits and certificates of deposit for all funds was $44,056,000 and $17,868,000, respectively, compared to bank balances of $43,469,000 and $17,354,000, respectively. The difference is caused primarily by items in transit. Of the bank balances, $5,389,000 and $3,684,000, respectively, were covered by federal government depository insurance or collateralized by a pledge of U.S. Treasury obligations held by Federal Reserve banks in the name of the banking institutions; $1,164,000 and $521,000, respectively, were uninsured and uncollateralized; and $36,916,000 and $13,149,000, 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.

Board of Governors Policy 1986-02-A: *Investment*, authorizes the State System 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, the State System 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 the State System'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.

The State System's operating funds are invested and reinvested in the following types of instruments with qualifications as provided. (See Board of Governors 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 U.S. Treasury and be in the State System'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 the State System'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: The State System 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: The State System 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. The State System 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. The State System's duration targets are not applicable to its long-term investments.

Fair Value Hierarchy: GASB Statement No. 72, *Fair Value Measurement and Application*, requires that investments be classified according to a "fair value hierarchy." With respect to Statement No. 72's fair value hierarchy, GASB defines "inputs" as "the assumptions that market participants would use when pricing an asset or liability, including assumptions about risk." Statement No. 72 further categorizes inputs as *observable* or *unobservable*: *Observable inputs* are "inputs that are developed using market data, such as publicly available information about actual events or transactions, and which reflect the assumptions that market participants would use when pricing an asset or liability"; *Unobservable inputs* are "inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing an asset or liability."

Statement No. 72's fair value hierarchy categorizes the inputs to valuation techniques used to measure fair value into three "levels":

Level 1: Investments whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market, such as stocks listed in the S&P 500 or NASDAQ. If an up-to-date price of the investment can be found on a major exchange, it is a Level 1 investment.

Level 2: Investments whose values are based on their quoted prices in inactive markets or whose values are based on models, and the inputs to those models are observable either directly or indirectly for substantially the full term of the asset or liability.

Level 3: Investments that trade infrequently, and as a result do not have many reliable market prices. Valuations of Level 3 investments typically are based on management assumptions or expectations. For example, a private equity investment or complex derivative would likely be a Level 3 investment.

In addition, the fair value of certain investments that do not have a readily determinable fair value is classified as *NAV*, meaning Net Asset Value per share, when the fair value is calculated in a manner consistent with the Financial Accounting Standards Board's measurement principles for investment companies.

Debt and equity securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Debt and equity securities classified in Level 2 of the fair value hierarchy are valued using a matrix pricing technique. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices. Securities classified in Level 3 of the fair value hierarchy lack an independent pricing source and so are valued using an internal fair value as provided by the investment manager.

Commonfund investments, held locally by some of the universities, are valued based upon the unit values (NAV) of the funds held by the universities at year end. Unit values are based upon the underlying assets of the funds derived from inputs principally from or corroborated by observable market data, by correlation, or other means. Redemption restrictions for the Commonfund vary, depending upon the type of fund in which the universities have invested, and are restricted to withdrawals only on a weekly basis or the last business day of the month. All withdrawals require five days' notice.

State System Pooled Deposits and Investments
The carrying values (fair values) of deposits and investments for the State System's pooled funds in M&T Bank on June 30, 2018 and 2017, follow.

State System Pooled Deposits and Investments
June 30, 2018
(in thousands)

	Fair Value Hierarchy Level	Moody's Rating (if applicable)	Modified Duration (if applicable)	Fair Value
Deposits				
Demand and time deposits				$3
Money market funds				29,931
Total deposits				29,934
Investments				
Commercial paper	2	Aaa	0.09	147,471
Government money market mutual fund	2	Aaa	0.00	57,489
	2	Aa3	1.41	5,158
U.S. government and agency obligations	2	Aaa	1.31	432,013
Asset-backed securities	2	Aaa	0.59	112,737
	2	Aa1	0.75	28,079
Collateralized mortgage obligations (CMOs)	2	Aaa	2.23	158,433
Corporate bonds and notes	2	Aa1	0.01	2,001
	2	Aa2	1.17	4,509
	2	Aa3	0.74	7,984
	2	A1	1.91	57,849
	2	A2	1.38	50,449
	2	A3	1.31	75,863
	2	Baa1	1.85	42,985
	2	Baa2	1.29	15,625
	2	Baa3	0.00	726
Total investments				1,199,371
Total deposits and investments				$1,229,305

State System Pooled Deposits and Investments
June 30, 2017
(in thousands)

	Fair Value Hierarchy Level	Moody's Rating (if applicable)	Modified Duration (if applicable)	Fair Value
Deposits				
Money market funds				$6,163
Total deposits				6,163
Investments				
Commercial paper	2	P1	0.15	218,032
Government money market mutual fund	2	Aaa	0.00	141,939
U.S. government and agency obligations	2	Aaa	2.10	362,456
Asset-backed securities	2	Aaa	0.85	103,492
Collateralized mortgage obligations (CMOs)	2	Aaa	2.29	199,721
Corporate bonds and notes	2	Aaa	0.38	6,011
	2	Aa1	0.51	8,710
	2	Aa2	0.75	7,734
	2	Aa3	0.97	13,332
	2	A1	1.38	62,803
	2	A2	1.53	56,579
	2	A3	1.87	45,265
	2	Ba1	0.25	3,140
	2	Baa1	1.70	35,555
	2	Baa2	1.74	22,805
	2	Baa3	0.00	726
Total investments				1,288,300
Total deposits and investments				$1,294,463

Of the investments noted above at June 30, 2018 and 2017, $22,312,000 and $17,381,000, 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 10). Such 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.

University Local Deposits and Investments

The carrying values (fair values) of local university deposits and investments on June 30, 2018 and 2017, follow.

University Local Deposits and Investments
June 30, 2018
(in thousands)

	Fair Value Hierarchy Level	**Moody's Rating** (if applicable)	**Modified Duration** (if applicable)	**Fair Value**
Deposits				
Demand and time deposits				$14,108
Certificates of deposit				14
Total deposits				14,122
Investments				
U.S. government and agency obligations	2		0.51	78
Bond mutual funds	1		5.07	2,434
	NAV		5.11	12,690
Debt securities	2	Aa1	7.70	19
	2	Aaa	3.35	375
Equity/balanced mutual funds	1			13,558
	2			5,853
	3			1,665
	NAV			22,997
Common stock	1			2,723
Total investments				62,392
Total deposits and investments				$76,514

University Local Deposits and Investments
June 30, 2017
(in thousands)

	Fair Value Hierarchy Level	**Moody's Rating** (if applicable)	**Modified Duration** (if applicable)	**Fair Value**
Deposits				
Demand and time deposits				$11,691
Certificates of deposit				14
Total deposits				11,705
Investments				
U.S. government and agency obligations	2	N/A	0.51	100
Bond mutual funds	1		5.36	1,058
	2		5.61	1,321
	NAV		4.85	11,457
Debt securities	2	Aa1	4.20	25
	2	Aa2	0.99	55
Equity/balanced mutual funds	1			5,932
	2			5,993
	3			9,361
	NAV			21,692
Common stock	1			2,489
Total investments				59,483
Total deposits and investments				$71,188

(3) Beneficial Interests

At June 30, 2018, the fair value of beneficial interests totaled $23,493,000. Of this amount, $23,483,000 represents gifts that donors placed in trust in perpetuity with third parties, with the respective universities receiving a restricted revenue stream in accordance with the donors' wishes, and $10,000 represents a split-interest agreement that a donor placed in trust with a third party, and to which the university will take title upon the death of the donor.

(4) Capital Assets

The classifications of capital assets and related depreciation at June 30, 2018 and 2017, follow.

(in thousands)

	Balance June 30, 2016	2016/17 Additions	2016/17 Retirements/ Adjustments	Balance June 30, 2017	2017/18 Additions	2017/18 Retirements/ Adjustments	Balance June 30, 2018
Land	$32,360	-	-	$32,360	$153	-	$32,513
Construction in progress	80,012	$140,455	($37,164)	183,303	91,004	($168,125)	106,182
Total capital assets not being depreciated	112,372	140,455	(37,164)	215,663	91,157	(168,125)	138,695
Buildings, including improvements	2,213,463	209,277	9,975	2,432,715	40,696	144,644	2,618,055
Improvements other than buildings	285,136	6,383	6,678	298,197	6,814	2,976	307,987
Equipment and furnishings	470,347	25,208	(7,582)	487,973	20,487	(5,230)	503,230
Library books	81,314	731	(1,311)	80,734	663	(1,895)	79,502
Total capital assets being depreciated	3,050,260	241,599	7,760	3,299,619	68,660	140,495	3,508,774
Less accumulated depreciation:							
Buildings and improvements	(916,706)	(90,456)	11,118	(996,044)	(95,205)	12,274	(1,078,975)
Land improvements	(139,286)	(10,526)	100	(149,712)	(10,904)	2,047	(158,569)
Equipment and furnishings	(379,315)	(29,563)	13,182	(395,696)	(28,775)	9,085	(415,386)
Library books	(74,036)	(1,723)	1,311	(74,448)	(1,538)	1,895	(74,091)
Total accumulated depreciation	(1,509,343)	(132,268)	25,711	(1,615,900)	(136,422)	25,301	(1,727,021)
Total capital assets being depreciated, net	1,540,917	109,331	33,471	1,683,719	(67,762)	165,796	1,781,753
Capital assets, net	$1,653,289	$249,786	($3,693)	$1,899,382	$23,395	($2,329)	$1,920,448

(5) Workers' Compensation

The State System is self-insured for workers' compensation losses. For claims occurring prior to July 1, 1995, State System universities must pay up to $100,000; for claims occurring on or after July 1, 1995, State System 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 State System universities contribute an amount determined by an independent actuarial study. Based on updated actuarial studies, the universities contributed $1,633,000, $372,000, and $1,405,000 to the Reserve Fund during the years ended June 30, 2018, 2017, and 2016, respectively.

For the years ended June 30, 2018, 2017, and 2016, the aggregate liability for claims under the self-insurance limit was $9,327,000, $8,554,000, and $9,345,000, respectively. The Reserve Fund assets of $13,121,000, $11,813,000, and $12,746,000 are equal to the liability for claims in excess of the self-insurance limits for the years ended June 30, 2018, 2017, and 2016, respectively. Changes in the workers' compensation claims liability in fiscal years 2018, 2017, and 2016 follow.

(in thousands)

Year	Beginning Balance	Current Year Claims and Changes in Estimates	Claim Payments	Ending Balance
2016	$22,550	$3,465	$3,924	$22,091
2017	$22,091	$2,313	$4,037	$20,367
2018	$20,367	$6,049	$3,968	$22,448

(6) Compensated Absences

Compensated absences are absences, such as vacation and sick leave, for which employees will be paid in cash at termination or retirement. Changes in the compensated absences liability in fiscal years 2018 and 2017 are as follows.

(in thousands)

Year	Beginning Balance	Current Changes in Estimates	Less Payouts	Ending Balance
2017	$115,423	$13,776	$9,673	$119,526
2018	$119,526	$17,061	$10,386	$126,201

(7) Pension Benefits

Employees of the State System enroll in one of three available retirement plans immediately upon employment: the Commonwealth of Pennsylvania State Employees' Retirement System (SERS), the Public School Employees' Retirement System (PSERS), or the Alternative Retirement Plan (ARP).

Following is the total of the State System's pension liabilities, deferred outflows and inflows of resources related to pensions, and the pension expense for the fiscal years ended June 30, 2018 and 2017.

(in thousands)

	SERS		PSERS		ARP		Total	
	2018	2017	2018	2017	2018	2017	2018	2017
Net pension liabilities	**$848,315**	**$931,620**	**$89,442**	**$90,838**	**$0**	**$0**	**$937,757**	**$1,022,458**
Deferred outflows of resources:								
Difference between expected and actual experience	$14,343	$13,448	$933	–	–	–	$15,276	$13,448
Net difference between projected and actual investment earnings on pension plan investments	–	78,293	2,073	$5,063	–	–	2,073	83,356
Changes in assumptions	42,472	56,905	2,430	3,279	–	–	44,902	60,184
Difference between employer contributions and proportionate share of contributions	–	–	506	555	–	–	506	555
Changes in proportion	20,281	14,478	1,602	2,576	–	–	21,883	17,054
Contributions after the measurement date	53,756	51,532	7,880	7,107	–	–	61,636	58,639
Total deferred outflows of resources	**$130,852**	**$214,656**	**$15,424**	**$18,580**	**$0**	**$0**	**$146,276**	**$233,236**
Deferred inflows of resources:								
Difference between expected and actual experience	$16,107	$20,844	$540	$757	–	–	$16,647	$21,601
Net difference between projected and actual investment earnings on pension plan investments	33,729	–	–	–	–	–	33,729	–
Difference between employer contributions and proportionate share of contributions	4,899	4,323	–	–	–	–	4,899	4,323
Changes in proportion	13,301	19,754	1,297	662	–	–	14,598	20,416
Total deferred inflows of resources	**$68,036**	**$44,921**	**$1,837**	**$1,419**	**$0**	**$0**	**$69,873**	**$46,340**
Pension expense	**$118,342**	**$130,551**	**$19,902**	**$20,223**	**$45,118**	**$45,343**	**$183,362**	**$196,117**
Contributions recognized by pension plans	**$94,727**	**$83,754**	**$7,880**	**$7,107**	**N/A**	**N/A**	**$102,607**	**$90,861**

The State System will recognize the $53,756,000 reported as 2018 SERS deferred outflows of resources resulting from pension contributions after the measurement date, and the $7,880,000 reported as 2018 PSERS deferred outflows of resources resulting from pension contributions after the measurement date, as reductions of the respective net pension liabilities in the year ended June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows.

(in thousands)

	Amortization	
Fiscal Year Ended	**SERS**	**PSERS**
June 30, 2019	$19,052	$1,991
June 30, 2020	$14,230	$2,868
June 30, 2021	($7,666)	$1,301
June 30, 2022	($17,155)	($453)
June 30, 2022	$599	$0
Totals	$9,060	$5,707

SERS

Plan Description

SERS is the administrator of a cost-sharing multiple-employer defined benefit plan established by the Commonwealth to provide pension benefits for employees of state government and certain independent agencies. SERS is a component unit of the Commonwealth and is included in the Commonwealth's financial report as a pension trust fund. 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 from the SERS website at www.sers.state.pa.us.

Membership in SERS is mandatory for most state employees. Members and employees of the General Assembly, certain elected or appointed officials in the executive branch, department heads, and certain employees in the field of education are not required, but are given the option, to participate.

Benefits Provided

SERS provides retirement, death, and disability benefits. Article II of the Commonwealth's Constitution assigns the authority to establish and amend the benefit provision of the plan to the General Assembly. Cost of Living Adjustments (COLA) are provided ad hoc at the discretion of the General Assembly.

Employees who were hired prior to January 1, 2011, and retire at age 60 with three years of service, or with 35 years of service if under age 60, are entitled to a normal annual retirement benefit; members of the General Assembly and certain employees classified in hazardous duty positions can retire with full benefits at age 50 with at least three years of service. Act 120 of 2010 (Act 120) preserved all benefits in place for members, but mandated a number of benefit reductions for new members effective January 1, 2011. The benefit reduction included a new class of membership that accrues benefits at 2% of members' final average salary instead of the previous 2.5%. The vesting period changed from 5 to 10 years of credited service, and the option to withdraw lump-sum accumulated deductions was eliminated. The new normal retirement age is 65 for most employees and 55 for members of the General Assembly and certain employees classified in hazardous duty positions.

According to the State Employees' Retirement Code (SERC), all obligations of SERS will be assumed by the Commonwealth should SERS terminate.

Contributions

The contribution rate for both active members and the State System depends upon when the active member was hired and what benefits class was selected. Section 5507 of the SERC (71 Pa. C.S. §5507) requires the Commonwealth and other employers whose employees are SERS members to make contributions on behalf of all active members and annuitants to fund the liabilities and provide the annuity reserves required to pay benefits. The SERS funding policy, as set by the SERS Board, provides for periodic active member contributions at statutory rates. The SERS funding policy also provides for periodic employer contributions at actuarially determined rates based on SERS' funding valuation, expressed as a percentage of annual retirement covered payroll, such that the employer contributions, along with employee contributions and an actuarially determined rate of investment return, are adequate to accumulate assets to pay benefits when due.

The State System contributed at actuarially determined rates of between 23.80% and 34.44%

of active members' annual covered payroll at June 30, 2018. The State System's contributions to SERS for the years ended June 30, 2018, 2017, and 2016, were $94,727,000, $83,754,000, and $69,021,000, respectively, equal to the required contractual contribution.

Contribution rates for most active members is 6.25% of gross salary. The contribution rate for other members ranges between 5% and 9.3% of salary, depending upon when the member was hired and what class of membership was elected.

Actuarial Methods and Assumptions
Every five years, SERS is required to conduct an actuarial experience study to determine whether the assumptions used in its annual actuarial valuations remain accurate based on current and anticipated demographic trends and economic conditions. The *18th Investigation of Actuarial Experience* study for the period 2011–2015 was released in March 2016. The actuary, under oversight of the SERS Board, reviewed economic assumptions (such as the assumed future investment returns and salary increases) as well as demographic assumptions (such as employee turnover, retirement, disability, and death rates). Some assumption adjustments increased projected cost and some decreased it, but the overall result was a slight increase to the net pension liability. The SERS Board adopted the actuarial assumptions set forth in the *18th Investigation of Actuarial Experience* at its March 2016 meeting. In addition, SERS reviews its investment return assumption in light of economic conditions every year.

The following methods and assumptions were used in the actuarial valuation for the December 31, 2017, measurement date.

- Entry age actuarial cost method.
- Straight-line amortization on a closed-period basis of investments over five years and amortization of assumption changes and noninvestment gains/losses over the average expected remaining service lives of all employees that are provided benefits.
- Inflation of 2.60%.
- Investment return of 7.25%, net of expenses and including inflation.
- Salary increases based on an average of 5.60%, with a range of 3.70% to 8.90%, including inflation.
- Asset valuation using fair (market) value.
- Mortality rates based on the projected RP-2000 Mortality Tables, adjusted for actual plan experience and future improvement.
- No cost of living adjustments.

The long-term expected real rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of manager fees and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in SERS' target asset allocation as of December 31, 2017, are summarized below.

Asset Class	Target Allocation	Long-Term Real Rate of Return
Private equity	16.00%	8.00%
Global public equity	43.00%	5.30%
Real estate	12.00%	5.44%
Multi-strategy	12.00%	5.10%
Fixed income	14.00%	1.63%
Cash	3.00%	(0.25%)
	100.00%	

At its April 2017 meeting, the SERS Board approved a reduction in the assumed investment rate of return to 7.25%. As a result of a portfolio examination, several changes were made to the asset allocation during the fourth quarter of 2017. The portfolio was restructured to add Multi-strategy as a new asset class. Targets will be updated to reflect the new assumed investment rate of return and asset classes in the *2018-19 Investment Plan*.

The discount rate used to measure the total SERS pension liability was 7.25%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the rates applicable for each member and that employer contributions will be made based on rates determined by the actuary and as set by statute. Based on those assumptions, SERS' fiduciary net position was projected to be available to make all projected future benefit payments of current active and non-active SERS members. The long-term expected rate of return on SERS' investments, therefore, was applied to all periods of projected benefit payments to determine the total pension liability.

The following presents the State System's proportionate share of the SERS net pension liability at June 30, 2018, calculated using the discount rate of 7.25%, as well as what the SERS net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.25%) or one percentage point higher (8.25%) than the current rate.

Sensitivity of the State System's Proportionate Share of the SERS Net Pension Liability to Changes in the Discount Rate
(in thousands)

1% Decrease 6.25%	Current Rate 7.25%	1% Increase 8.25%
$1,076,776	$848,315	$652,611

The following presents the State System's proportionate share of the SERS net pension liability at June 30, 2017, calculated using the discount rate of 7.25%, as well as what the SERS net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.25%) or one percentage point higher (8.25%) than the current rate.

Sensitivity of the State System's Proportionate Share of the SERS Net Pension Liability to Changes in the Discount Rate
(in thousands)

1% Decrease 6.25%	Current Rate 7.25%	1% Increase 8.25%
$1,152,923	$931,620	$742,106

Fiduciary Net Position
The fiduciary net positions of SERS, as well as additions to and deductions from SERS fiduciary net positions, have been determined on the same basis as they are reported in the SERS financial statements, which can be found at www.sers.state.pa.us. The plan schedules of SERS are prepared using the accrual basis of accounting and economic resources measurement focus in accordance with U.S. GAAP as prescribed by the GASB. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has a legal requirement to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Investment purchases and sales are recorded on a trade-date basis. Detailed information on investment valuation can be found in the SERS financial statements. Management of SERS has made certain estimates and assumptions relating to employer allocation schedules, and actual results could differ.

Proportionate Share
At June 30, 2018, the amount recognized as the State System's proportionate share of the SERS net pension liability, measured at December 31, 2017, was $848,315,000. At June 30, 2017, the amount recognized as the State System's proportionate share of the SERS net pension liability, measured at December 31, 2016, was $931,620,000.

The allocation percentage assigned to each participating employer is based on a projected-contribution method. For the allocation of the December 2017 amounts, this methodology applies the most recently calculated contribution rates for fiscal year 2018/19, from the December 31, 2017, funding valuation, to the expected funding payroll. For the allocation of the December 2016 amounts, this methodology applies the most recently calculated contribution rates for fiscal year 2017/18, from the December 31, 2016, funding valuation, to the expected funding payroll. At the December 31, 2017, measurement date, the State System's proportion was 4.906%, an increase of 0.07% from its proportion calculated as of the December 31, 2016, measurement date.

PSERS
Plan Description
PSERS is a governmental cost-sharing multiple-employer defined benefit pension plan that provides retirement, disability, and death benefits to public school employees of the Commonwealth. The members eligible to participate in PSERS include all full-time public school employees, part-time hourly public school employees who render at least 500 hours of service in the school year, and part-time per diem public school employees who render at least 80 days of service in the school year in any of the reporting entities in Pennsylvania. The Public School Employees' Retirement Code (Act No. 96 of October 2, 1975, as amended) (24 Pa. C.S. §§8101–8535) (the Code) is the authority by which PSERS benefits provisions and contribution requirements are established. The Commonwealth's General Assembly has the authority to amend the benefit terms by passing

bills in the Senate and House of Representatives and sending them to the Governor for approval. The Code requires contributions by active members, the employer (State System), and the Commonwealth. PSERS is a component unit of the Commonwealth and is included in the Commonwealth's financial report as a pension trust fund. PSERS issues a comprehensive annual financial report that may be obtained at www.psers.state.pa.us.

Benefits Provided
Members who joined prior to July 1, 2011, are eligible for monthly retirement benefits upon reaching age 62 with at least one year of credited service, age 60 with 30 or more years of credited service, or any age with 35 or more years of service. Act 120 preserved the benefits of members who joined prior to July 1, 2011, and introduced benefit reductions for individuals who become new members on or after July 1, 2011, by creating two new membership classes: Class T-E and Class T-F. To qualify for normal retirement, Class T-E and Class T-F members must complete a minimum of 35 years of service with a combination of age and service that totals 92 or greater, or they must work until age 65 with a minimum of three years of service.

Depending upon membership class, benefits are generally 2% or 2.5% of the member's final average salary (as defined in the Code) multiplied by the number of years of credited service. Members who joined prior to July 1, 2011, vest after completion of five years of service and may elect early retirement benefits. Class T-E and Class T-F members vest after completion of 10 years of service.

Participants are eligible for disability retirement benefits after completion of five years of credited service. Such benefits are generally equal to 2% or 2.5%, depending upon membership class, of the member's final average salary (as defined in the Code) multiplied by the number of years of credited service, but not less than one-third of such salary nor greater than the benefit the member would have had at normal retirement age. Members over normal retirement age may apply for disability benefits.

Death benefits are payable upon the death of an active member who has reached age 62 with at least one year of credited service (age 65 with at least three years of credited service for Class T-E and Class T-F members) or has at least five years of credited service (10 years for Class T-E and Class T-F members). Such benefits are actuarially equivalent to the benefit that would have been effective if the member had retired on the day before death.

Member Contributions
Active members who joined PSERS prior to July 22, 1983, contribute at 5.25% (Class T-C members) or at 6.50% (Class T-D members) of the member's qualifying compensation. Members who joined PSERS on or after July 22, 1983, and who were active or inactive as of July 1, 2001, contribute at 6.25% (Class T-C) or at 7.5% (Class T-D) of the member's qualifying compensation. Members who joined PSERS after June 30, 2001, and before July 1, 2011, contribute at 7.5% (Class T-D). For these hires and for members who elected Class T-D, the 7.5% contribution rate began with service rendered on or after January 1, 2002. Members who joined PSERS after June 30, 2011, contribute at the rate of 7.5% (Class T-E) or 10.3% (Class T-F) of their qualifying compensation. Class T-E and Class T-F members are subject to a "shared risk" provision in Act 120 that could cause the rate in future years to fluctuate between 7.5% and 9.5% for Class T-E and 10.3% and 12.3% for Class T-F.

Employer Contributions
The State System's contractually required contribution rate for PSERS for fiscal year ended June 30, 2018, was 31.74% of covered payroll, actuarially determined as an amount that, when combined with employee contributions, is expected to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. Per §8327 of the Code, the Commonwealth is required to contribute 50% of the contribution rate directly to PSERS on behalf of the State System, meaning that the amount that the State System actually contributed was 15.87% of covered payroll. The State System's contribution to PSERS for the year ending June 30, 2018, June 30, 2017, and June 30, 2016, was $7,880,000, $7,107,000, and $6,012,000, respectively, equal to the required contractual contribution.

Actuarial Assumptions
The total PSERS pension liability as of June 30, 2017, was determined by rolling forward PSERS' total pension liability at June 30, 2016, to June 30, 2017, using the following actuarial assumptions, applied to all periods included in the measurement.

- Actuarial cost method is entry age normal, level percent of pay.
- Inflation of 2.75%.
- Investment return of 7.25%, including inflation.
- Salary increases based on an effective average of 5.0%, which comprises a 2.75% allowance for inflation and 2.25% for real wage growth and merit or seniority increases.
- Mortality rates based on the RP-2014 Mortality Tables for Males and Females, adjusted to reflect PSERS' experience and projected using a modified version of the MP-2015 Mortality Improvement Scale.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

PSERS' policy in regard to the allocation of invested plan assets is established and may be amended by the PSERS Board of Trustees. Plan assets are managed with a long-term objective of achieving and maintaining a fully funded status for the benefits provided through the pension. Following is the PSERS Board of Trustees' adopted asset allocation policy and best estimates of geometric real rates of return for each major asset class as of June 30, 2017.

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Global public equity	20.0%	5.1%
Fixed income	36.0%	2.6%
Commodities	8.0%	3.0%
Absolute return	10.0%	3.4%
Risk parity	10.0%	3.8%
Infrastructure/MLPs	8.0%	4.8%
Real estate	10.0%	3.6%
Alternative investments	15.0%	6.2%
Cash	3.0%	0.6%
Financing (LIBOR)	(20.0%)	1.1%
	100.0%	

The discount rate used to measure the total PSERS pension liability was 7.25%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate and that contributions from employers will be made at contractually required rates, actuarially determined. Based on those assumptions, PSERS' fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on PSERS' investments was applied to all periods of projected benefit payments to determine the total pension liability.

The following presents the State System's proportionate share of the PSERS net pension liability at June 30, 2018, calculated using the discount rate of 7.25%, as well as what the PSERS net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.25%) or one percentage point higher (8.25%) than the current rate.

Sensitivity of the State System's Proportionate Share of the PSERS Net Pension Liability to Changes in the Discount Rate
(in thousands)

1% Decrease 6.25%	Current Rate 7.25%	1% Increase 8.25%
$110,096	$89,442	$72,005

The following presents the State System's proportionate share of the PSERS net pension liability at June 30, 2017, calculated using the discount rate of 7.25%, as well as what the PSERS net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.25%) or one percentage point higher (8.25%) than the current rate.

Sensitivity of the State System's Proportionate Share of the PSERS Net Pension Liability to Changes in the Discount Rate
(in thousands)

1% Decrease 6.25%	Current Rate 7.25%	1% Increase 8.25%
$111,119	$90,838	$73,795

Fiduciary Net Position

For purposes of measuring the net pension liability, deferred outflows of resources, and deferred inflows of resources related to pensions and pension expense, the fiduciary net position of PSERS and additions to or deductions from PSERS' fiduciary net position have been determined on the same basis as they are reported in the PSERS' financial statements. For this purpose, benefit payments, including refunds of employee contributions, are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value. Detailed information about PSERS' fiduciary net position is available in the PSERS Comprehensive Annual Financial Report, which can be found at www.psers.state.pa.us.

Proportionate Share
The amount recognized as the State System's proportionate share of the PSERS net pension liability, plus the related PSERS pension support provided by the Commonwealth, is as follows.

(in thousands)	2018	2017
Total PSERS net pension liability associated with the State System	$178,884	$181,676
Commonwealth's proportionate share of the PSERS net pension liability associated with the State System	(89,442)	(90,838)
State System's proportionate share of the PSERS net pension liability	$89,442	$90,838

PSERS measured the 2018 and 2017 net pension liabilities as of June 30, 2017, and June 30, 2016, respectively. PSERS calculated the employer's proportion of the net pension liability using the employer's one-year reported covered payroll in relation to all participating employers' one-year reported covered payroll. At June 30, 2017, the State System's proportion was .1811%, a decrease of .0022% from its proportion calculated as of June 30, 2016.

ARP
The ARP is a defined contribution pension plan administered by the State System. 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. The State System recognizes annual pension expenditures equal to its contractually required contributions to the plan. The State System's contribution rate on June 30, 2018 and 2017, was 9.29% of qualifying compensation.

The contributions to the ARP for the years ended June 30, 2018 and 2017, were $45,118,000 and $45,343,000, respectively, from the State System; and $23,535,000 and $25,492,000, respectively, from active members. No liability is recognized for the ARP.

(8) Other Postemployment Benefits (OPEB)

Other postemployment benefits (OPEB) are benefits, such as healthcare benefits, that are paid in the period after employment and that are provided separately from a pension plan. OPEB does not include termination benefits or termination payments for sick leave. (See note 6.)

State System employees who retire after meeting specified service and age requirements are eligible to receive healthcare and tuition benefits in retirement. 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), Office and Professional Employees International Union (OPEIU), and nonrepresented employees participate in a defined benefit healthcare plan administered by the State System (System Plan). 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 a defined benefit healthcare plan sponsored by the Commonwealth and administered by the Pennsylvania Employee Benefits Trust Fund (PEBTF). In addition to the above, any employee who participates in the Public School Employees' Retirement System (PSERS) pension plan is eligible to receive benefits from the PSERS Health Insurance Premium Assistance Program (Premium Assistance), a defined benefit plan, and all eligible retirees and their eligible dependents receive tuition waivers at any of the 14 State System universities.

Following is the total of the State System's OPEB liabilities, deferred outflows and inflows of resources related to OPEB, and the OPEB expense for the fiscal years ended June 30, 2018, and 2017.

(in thousands)	System Plan		REHP		Premium Assistance		Total	
	2018	2017	2018	2017	2018	2017	2018	2017
Net OPEB liabilities	**$1,460,042**	**$1,145,088**	**$860,881**	*	**$3,690**	*	**$2,324,613**	**$1,145,088**
Deferred outflows of resources:								
Net difference between projected and actual investment earnings on OPEB plan investments	N/A	N/A	–	*	$4	*	$4	*
Contributions after the measurement date	$37,657	*	$21,441	*	204	*	59,302	*
Total deferred outflows of resources	**$37,657**	–	**$21,441**	–	**$208**	–	**$59,306**	–
Deferred inflows of resources:								
Net difference between projected and actual investment earnings on OPEB plan investments	N/A	N/A	$719	*	–	*	$719	*
Changes in assumptions	$119,334	*	78,438	*	$172	*	197,944	*
Changes in proportion	N/A	N/A	–	*	41	*	41	*
Total deferred inflows of resources	**$119,334**	**–**	**$79,157**	**–**	**$213**	**–**	**$198,704**	**–**
OPEB expense	**$58,709**	**$77,686**	**$39,964**	**$31,875**	**$303**	**$202**	**$98,976**	**$109,763**
Contributions recognized by OPEB plans	N/A	N/A	**$21,441**	**$31,875**	**$204**	**$202**	**$21,645**	**$32,077**

**Information is not reported because GASB 75 actuarial valuations were not performed for prior years and fiscal year 2016/17 was not restated.*

The State System will recognize the deferred outflows of resources resulting from contributions after the measurement date, totaling $37,657,000 for the System Plan, $21,441,000 for the REHP plan, and $204,000 for the PSERS OPEB plan, as reductions of the respective net OPEB liabilities in the year ended June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows.

(in thousands)	Amortization		
Fiscal Year Ended	**System Plan**	**REHP**	**Premium Assistance**
June 30, 2019	$23,867	$16,835	$34
June 30, 2020	$23,867	$16,835	$35
June 30, 2021	$23,867	$16,835	$35
June 30, 2022	$23,867	$16,835	$35
June 30, 2023	$23,866	$11,824	$35
Thereafter	$0	($7)	$35
Totals	$119,334	$79,157	$209

System Plan

Plan Description

The System Plan is a single-employer defined benefit healthcare plan administered by the Office of the Chancellor. Act 188 empowers the Board to establish and amend benefit provisions and to require the Office of the Chancellor to pay OPEB as the benefits come due. The Office of the Chancellor discretely accounts for and accumulates all employer and employee System Plan contributions that have been collected from the universities, employees, and retirees, but not yet been paid to the provider; however, the System Plan has no assets accumulated in a trust in which the employer contributions are irrevocable, are dedicated to providing OPEB to plan members, or are legally protected from creditors.

The System Plan provides eligible retirees and their eligible dependents with healthcare benefits, including hospital, medical/surgical, prescription drugs, and major medical coverage, as well as a Medicare supplement for individuals over age 65. Retirees receive varying coverages based on the benefits in effect when they retired, and benefits may continue for the retiree's lifetime. Spouse benefits cease upon the retiree's death, but the surviving spouse may continue coverage at full cost. Non-spouse dependents may be covered until age 19 or until age 25 if a certified full-time student. SCUPA, SPFPA, OPEIU, and nonrepresented employees whose retirement date is on or after January 1, 2016, and APSCUF employees whose retirement date is on or after July 1, 2017, receive the same pre-Medicare benefits as active employees, with benefits changing as active employee benefits change. All other retirees continue to receive the same benefits to which they were entitled at retirement.

A total of 12,511 employees are covered by the benefit terms, including 7,762 inactive employees currently receiving benefit payments, 52 inactive employees entitled to but not yet receiving benefits, and 4,697 active employees. Effective January 16, 2016, the State System OPEB plan became closed to newly hired SCUPA, SPFPA, OPEIU, and nonrepresented employees, while newly hired APSCUF employees (faculty and coaches) continue to be eligible to participate in the plan.

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 or the contribution rate for active employees, and applicable collective bargaining agreements. Following are the contribution rates of eligible plan members receiving benefits as of June 30, 2018.

- Plan members who retired prior to July 1, 2005, are not required to make contributions.
- Plan members, with the exception of nonfaculty coaches, who retired on or after July 1, 2005, and prior to July 1, 2008, and who are under age 65, pay the same dollar amount they paid as active employees on the day of retirement. When these plan members become eligible for Medicare, they pay 18% 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.
- Plan members, with the exception of nonfaculty coaches, who retire on or after July 1, 2008, pay 18% of the plan premium in effect for active employees on their retirement date. Future adjustments will apply if contributions increase for active employees.
- Nonfaculty coaches who retired on or after July 1, 2005, pay 2.75% of their final annual gross salary at the time of retirement.

Actuarial Assumptions and Other Inputs
The actuarial valuation on which the total OPEB liability is based is dated July 1, 2016. Update procedures were used to roll forward the total OPEB liability to the measurement date of July 1, 2017. The total OPEB liability was measured using the following actuarial assumptions and other inputs, applied to all periods included in the measurement, unless otherwise specified:

- Inflation of 2.2%.
- Healthcare cost trend rate of 6.0% in 2017 and 5.5% in 2018 through 2023, with rates gradually decreasing from 5.4% in 2024 to 3.9% in 2075 and later, based on the Society of Actuaries Long-Run Medical Cost Trend Model. The healthcare cost trend rate was updated based on the Society of Actuaries Getzen Model.
- Annual salary increase of 4%, updated from 3%.
- 90% of employees are assumed to elect coverage. 75% of vested former members who have not yet reached age 65 are assumed to begin electing coverage at age 65.
- The per capita claims cost for medical and prescription drugs is based on the expected portion of the group's overall cost attributed to individuals in specified age and gender brackets.
- The cost due to the excise tax under the Patient Protection and Affordable Care Act beginning in 2020 is 40% of the projected premiums in excess of the annual limits.
- The annual cost of living increase beginning in 2018 is assumed to be 2.2% per year.
- Retiree premium cost sharing is assumed to remain at 18% and increase at the same rate as the Health Care Cost Trend Rate.
- Mortality rates based on the RP-2014 Total Mortality Tables, which incorporate rates based on a generational projection using Scale MP-2017 to reflect mortality improvement, updated from Scale MP-2016.
- The discount rate increased from 2.49% to 3.13%, based on S&P Municipal Bond 20 Year High Grade Rate Index.
- Participant data is based on census information as of July 1, 2016.
- Experience was last reviewed in 2012 for withdrawal and retirement. Experience for election percentages were reviewed in 2017. Neither of these reviews were published in a formal study.

- Costs have been loaded by 0.7% to account for tuition waiver benefits, which are offered to all retirees, regardless of employee bargaining unit when active and including those not represented when active, who meet years of service and/or age criteria.

The following presents the System Plan's net OPEB liability, as well as what the liability would be if it were calculated using healthcare cost trend rates that are one percentage point lower (5.0% decreasing to 2.9%) or one percentage point higher (7.0% decreasing to 4.9%) than the current healthcare cost trend rates (6.0% decreasing to 3.9%).

Sensitivity of the System Plan's Net OPEB Liability to Changes in the Healthcare Cost Trend Rate
(in thousands)

1% Decrease (5.0% decreasing to 2.9%)	Healthcare Cost Trend Rates (6.0% decreasing to 3.9%)	1% Increase (7.0% decreasing to 4.9%)
$1,208,892	$1,460,042	$1,787,836

The following presents the State System's net OPEB liability, as well as what the liability would be if it were calculated using a discount rate that is one percentage point lower (2.13%) or one percentage point higher (4.13%) than the current healthcare cost trend rates (3.13%).

Sensitivity of the System Plan's Net OPEB Liability to Changes in the Discount Rate
(in thousands)

1% Decrease 2.13%	Current Rate 3.13%	1% Increase 4.13%
$1,720,829	$1,460,042	$1,254,178

System Plan OPEB Liability
The System Plan's total OPEB liability of $1,460,042,000 was measured as of July 1, 2017, and was determined by an actuarial valuation as of July 1, 2016.

Changes in the System Plan Total OPEB Liability

(in thousands)	Fiscal Year Ending June 30, 2018
Balance at July 1, 2016	$1,559,134
Service Cost	48,636
Interest	39,441
Changes of Assumptions	(143,201)
Benefit Payments	(43,968)
Net Changes	(99,092)
Balance at July 1, 2017	$1,460,042

REHP
Plan Description
The Retired Employees Health Program (REHP) is a single-employer defined benefit OPEB plan that includes Commonwealth agencies and some component units. The REHP is established as a trust equivalent arrangement. The REHP is administered by the Pennsylvania Employees Benefit Trust Fund (PEBTF), which acts as a third-party administrator under an agreement with the Commonwealth. The REHP is provided as part of collective bargaining agreements with most Commonwealth labor unions. All policy decisions and types and levels of benefits for the REHP fall under the purview of the Commonwealth's Executive Board and the Secretary of Administration. The REHP does not have a governing board. Benefit 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, but is reported in the Commonwealth's Comprehensive Annual Financial Report (CAFR) as a Pension (and Other Employee Benefit) Trust. The CAFR is an audited financial statement and is available at www.budget.pa.us.

The REHP provides eligible retirees and their eligible dependents with healthcare benefits, including hospital, medical/surgical, prescription drugs, and major medical coverage, as well as a Medicare supplement for individuals over age 65. Retirees receive varying coverages based on the plan they choose, and benefits may continue for the retiree's lifetime. Spouse benefits cease upon the retiree's death, but the surviving spouse may continue coverage at full cost. Non-spouse dependents may be covered until age 26.

Plan members receiving benefits contribute at various rates, depending upon when they retire, whether they are eligible for Medicare, and their salary at retirement. Following are the contribution rates of eligible plan members receiving benefits as of June 30, 2018.

- Plan members who retired prior to July 1, 2005, are not required to make contributions.
- Plan members who retired on or after July 1, 2005, and prior to July 1, 2007, pay 1% of their final annual salary.
- Plan members who retired on or after July 1, 2007, and prior to July 1, 2011, pay 3% of either final gross annual base salary or final average salary, whichever is less. Members eligible for Medicare pay 1.5% of either final gross annual base salary or final average salary, whichever is less.
- Plan members who retire on or after July 1, 2011, pay 3% of final average salary. Members eligible for Medicare pay 1.5% of final gross annual base salary.

Employer contribution requirements are established by the Commonwealth as provided by pertinent statutory authority. With the exception of certain employing agencies, employers contributed to the REHP Trust a retiree health assessment rate of $300 for each current REHP eligible active employee during the period July 1, 2017, through January 18, 2018, and $188 from January 19, 2018, though June 30, 2018. The rate was $362 per biweekly pay period during the fiscal year ended June 30, 2017.

Actuarial Assumptions and Other Inputs
The total OPEB liability in the July 1, 2016, actuarial valuation was determined using the following actuarial assumptions and other inputs, applied to all periods included in the measurement, unless otherwise specified:

- Inflation of 2.60%.
- Healthcare cost trend rate of 6.0% in 2017 and 5.9% in 2018, with rates gradually decreasing to 3.9% in 2075 and later, based on the SOA-Getzen trend rate model version 2016_a.
- Average career salary growth of 2.65% per year and an assumed 2.90% general salary increase.
- Projected benefits based on estimates of future years of service and projected health benefit costs.
- Mortality rates based on the RP-2000 Male and Female Combined Healthy Mortality Tables or the RP-2000 Male and Female Disabled Retiree Mortality Tables, as appropriate, adjusted to ensure sufficient margin improvement in certain age ranges.
- Participant data based on census information as of December 31, 2016.
- Projected benefits based on estimates of future years of service and projected health benefit costs.

The Commonwealth's State Employees' Retirement System (SERS) performs experience studies periodically to determine reasonable and appropriate economic and demographic assumptions for purposes of valuing the defined benefit pension plan. The most recent SERS experience study covered the years 2011 through 2015 and was presented to the SERS Board in March 2016. The approved recommendations from that study were used to determine the assumptions in the REHP valuation, where applicable.

The following assumptions were made with regard to the discount rate:

- Discount rate of 3.58% as of June 30, 2017, and 2.85% as of June 30, 2016.
- Since the REHP has insufficient assets to meet next year's projected benefit payments, the discount rate is based on the rate for the 20-year tax-exempt general obligation municipal bond index with an average rating of AA/Aa or higher as of the measurement date. The Commonwealth elected to determine the discount rate using the Bond Buyer 20-Bond General Obligation Index.
- The long-term expected rate of return on REHP plan investments is determined using a risk premium review. This review compares the current relationship between fixed income and equity and their relationship over long periods of time to come up with an expected rate of return. Other variables considered in the expected rates of return are a

reversion to the mean for each asset class. Best estimates of arithmetic real rates of return for each major asset class included in the target asset allocation are summarized as follows:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
U.S. equity	47.00%	7.5%
International equity	20.00%	8.5%
Fixed income	25.00%	3.0%
Real estate	8.00%	3.0%
Cash	0.00%	1.0%
	100.00%	

The actuarial valuation on which the total REHP OPEB liability is based was dated July 1, 2017. The Commonwealth calculated an allocated share of the REHP OPEB liability for each participating employer based upon their actual contributions made to the REHP. The State System's proportion of the collective net OPEB liability was 4.37% for the measurement date of July 1, 2017.

The following presents the State System's share of the REHP net OPEB liability at June 30, 2018, as well as what the liability would be if it were calculated using healthcare cost trend rates that are one percentage point lower (5.0% decreasing to 2.9%) or one percentage point higher (7.0% decreasing to 4.9%) than the current healthcare cost trend rates (6.0% decreasing to 3.9%).

Sensitivity of the REHP Net OPEB Liability to Changes in the Healthcare Cost Trend Rate
(in thousands)

1% Decrease (5.0% decreasing to 2.9%)	Healthcare Cost Trend Rates (6.0% decreasing to 3.9%)	1% Increase (7.0% decreasing to 4.9%)
$747,111	$860,881	$1,031,191

The following presents the State System's share of the REHP net OPEB liability at June 30, 2017, as well as what the liability would be if it were calculated using a discount rate that is one percentage point lower (2.58%) or one percentage point higher (4.58%) than the current healthcare cost trend rates (3.58%).

Sensitivity of the REHP Net OPEB Liability to Changes in the Discount Rate
(in thousands)

1% Decrease 2.58%	Current Rate 3.58%	1% Increase 4.58%
$1,008,673	$860,881	$762,857

REHP Fiduciary Net Position

The REHP is reported in the Commonwealth's Comprehensive Annual Financial Report (CAFR) as a Pension (and Other Employee Benefit) Trust. The REHP is reported using the economic resources measurement focus and the accrual basis of accounting. The CAFR is an audited financial statement and is available at www.budget.pa.us.

The assets of the REHP are managed by the Commonwealth's Treasury in an investment pool. The REHP investments are made based upon an interagency agreement, dated June 17, 2008, and the prudent investor standard set forth in the Commonwealth of Pennsylvania's amendment to fiscal code 72 P.S. §30.1, the principles of Prudent Investors Standards.

Premium Assistance

Plan Description

The Health Insurance Premium Assistance Program (Premium Assistance) is a governmental cost sharing, multiple-employer OPEB plan administered by the administrative staff of PSERS. The members eligible to participate in the program include all full-time public school employees, part-time hourly public school employees who render at least 500 hours of service in the school year, and part-time per diem public school employees who render at least 80 days of service in the school year in any of the reporting entities in Pennsylvania. The control and management of PSERS, including the investment of its assets, is vested in the Board of Trustees (PSERS Board). The Commonwealth's General Assembly has the authority to amend the benefit terms of PSERS by passing bills in the Senate and House of Representatives and sending them to the Governor for approval.

Effective January 1, 2002, under the provisions of Act 9 of 2001, participating eligible retirees are entitled to receive premium assistance payments equal to the lesser of $100 per month or their out-of-pocket monthly health insurance premium. To receive premium assistance, eligible retirees must obtain their health insurance through either their school employer or the PSERS Health Options Program.

Plan members receiving benefits are not required to make contributions.

Employer contribution rates for Premium Assistance are established to provide reserves in the Health Insurance Account that are sufficient for the payment of Premium Assistance benefits for each succeeding year. The contribution policy is governed by applicable provisions of the Retirement Code. The contractually required employer contribution rate was 0.83% of covered payroll for the fiscal years ended June 30, 2018 and 2017. Per §8327 of the Code, the Commonwealth is required to contribute 50% of the contribution rate directly to PSERS on behalf of the State System, meaning that the amount that the State System actually contributed was 0.415% of covered payroll.

Actuarial Assumptions and Other Inputs
The total OPEB liability as of June 30, 2017, was determined by rolling forward the PSERS total OPEB liability as of June 30, 2016, to June 30, 2017, using the following actuarial assumptions, applied to all periods included in the measurement:

- Actuarial cost method was entry age normal, level percent of pay.
- Effective average salary growth of 5.0%, comprising 2.75% for inflation and 2.25% for real wage growth and for merit and seniority increases.
- Premium Assistance reimbursement benefits capped at $1,200 per year.
- Assumed healthcare cost trends were applied to retirees with less than $1,200 in premium assistance per year and assume a trend rate of between 5% and 8%.
- Mortality rates were based on the RP-2014 Mortality Tables for Males and Females, adjusted to reflect PSERS' experience and projected using a modified version of the MP-2015 Mortality Improvement Scale.
- Eligible retirees pre-age 65 are assumed to participate at 50%, while eligible retirees post-age 65 are assumed to participate at 70%.

The following assumptions were used to determine the contribution rate:

- The results of the actuarial valuation as of June 30, 2015, determined the employer contribution rate for fiscal year 2016/17.
- Cost method was developed using the amount necessary to assure solvency of Premium Assistance through the third fiscal year after the valuation date.
- Asset valuation method was market value.
- Participation rate assumed that 63% of eligible retirees will elect premium assistance.
- Mortality rates and retirement ages were based on the RP-2000 Combined Healthy Annuitant Tables with age set-back 3 for both males and females for healthy annuitants and for dependent beneficiaries, with adjustments made for disabled annuitants.

The following assumptions were made with regard to the discount rate:

- The discount rate used to measure the total OPEB liability was 3.13% at June 30, 2017, and 2.71% at June 30, 2016.
- Under the plan's funding policy, contributions are structured for short-term funding of Premium Assistance. The funding policy sets contribution rates necessary to assure solvency of Premium Assistance through the third fiscal year after the actuarial valuation date.
- The Premium Assistance account is funded to establish reserves that are sufficient for the payment of Premium Assistance benefits for each succeeding year. Due to the short-term funding policy, the OPEB plan's fiduciary net position was not projected to be sufficient to meet projected future benefit payments; therefore, the plan is considered to be a pay-as-you-go plan. A discount rate of 3.13%, which represents the S&P 20-year Municipal Bond Rate at June 30, 2017, was applied to all projected benefit payments to measure the total OPEB liability.
- Investments consist primarily of short-term assets designed to protect the principal of the plan assets. The OPEB plan's policy with regard to the allocation of invested plan assets is established and may be amended by the PSERS Board. Under the program, as defined in the retirement code, employer contribution rates for Premium Assistance are established to provide reserves in the health insurance account that are sufficient for the payment of premium assistance benefits for each succeeding year. Following is the PSERS Board's adopted asset allocation policy and best estimates of geometric real rates of return for each major asset class, as of June 30, 2017.

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Cash	76.4%	0.6%
Fixed income	23.6%	1.5%
	100.00%	

The actuarial valuation on which the total Premium Assistance OPEB liability is based was dated June 30, 2016. An employer's proportion is calculated utilizing the employer's one-year reported covered payroll as a percentage of total one-year reported covered payroll. The State System's proportion of the collective net OPEB liability was 0.18% for the measurement date of June 30, 2017.

The following presents the State System's share of the Premium Assistance net OPEB liability at June 30, 2018, as well as what the liability would be if it were calculated using healthcare cost trend rates that are one percentage point lower (between 4% and 7%) or one percentage point higher (between 6% and 9%) than the current healthcare cost trend rates (between 5% and 8%).

Sensitivity of the Premium Assistance Net OPEB Liability to Changes in the Healthcare Cost Trend Rate
(in thousands)

1% Decrease (between 4% and 7%)	Healthcare Cost Trend Rates (between 5% and 8%)	1% Increase (between 6% and 9%)
$3,689	$3,690	$3,691

The following presents the State System's share of the Premium Assistance net OPEB liability at June 30, 2017, as well as what the liability would be if it were calculated using a discount rate that is one percentage point lower (2.13%) or one percentage point higher (4.13%) than the current healthcare cost trend rates (3.13%).

Sensitivity of the Premium Assistance Net OPEB Liability to Changes in the Discount Rate
(in thousands)

1% Decrease 2.13%	Current Rate 3.13%	1% Increase 4.13%
$4,194	$3,690	$3,271

Premium Assistance Fiduciary Net Position
For purposes of measuring the net OPEB liability, deferred outflows of resources, and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of the PSERS, and additions to and deductions from PSERS' fiduciary net position, have been determined on the same basis as they are reported by PSERS. For this purpose, benefit payments are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value. Additional plan information can be found in the PSERS Comprehensive Annual Financial Report at www.psers.pa.gov.

(9) LEASES

Total rent expense for the State System operating leases amounted to $15,033,000 and $15,132,000 for the years ended June 30, 2018 and 2017, respectively.

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

(in thousands)	June 30, 2018	June 30, 2017
Cost:		
Buildings	$76,133	$76,305
Equipment	3,826	3,648
Total	$79,959	$79,953
Accumulated Depreciation:		
Buildings	$46,246	$42,302
Equipment	1,800	1,670
Total	$48,046	$43,972

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
2019	$6,601	$5,907
2020	5,454	5,594
2021	3,541	5,443
2022	3,122	5,191
2023	2,354	4,999
Thereafter	63,955	27,526
Total minimum lease payments	$85,027	54,660
Amount representing interest on capital leases		11,412
Present value of net minimum capital lease payments		$43,248

Changes in the liability for capital leases in fiscal years 2018 and 2017 follow.

(in thousands)

Year	Beginning Balance	Capital Lease Additions	Capital Lease Payments	Ending Balance
2017	$48,646	$1,348	$3,688	$46,306
2018	$46,306	$798	$3,856	$43,248

(10) Bonds Payable

Bonds payable on June 30, 2018 and 2017, consisted of several outstanding tax-exempt revenue bond series issued by the Pennsylvania Higher Educational Facilities Authority (PHEFA). In connection with the bond issuance, the State System entered into a loan agreement with PHEFA under which the State System has pledged its full faith and credit for the repayment of the bonds. The loan constitutes an unsecured general obligation of the State System. 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, 2018 and 2017, was as follows.

Bonds Payable
June 30, 2018 and 2017
(in thousands)

Description	Original Issuance	Weighted Average Interest Rate	Balance June 30, 2016	2017 Bonds Issued	2017 Bonds Redeemed/ Refunded	Balance June 30, 2017	2018 Bonds Issued	2018 Bonds Redeemed/ Refunded	Balance June 30, 2018	Current Portion
Series AG issued March 2008, final maturity June 2024	$101,335	4.52%	$48,145	-	$12,075	$36,070	-	$11,105	$24,965	$6,165
Series AH issued July 2008, final maturity June 2038	140,760	4.68%	110,350	-	4,655	105,695	-	97,535	8,160	390
Series AI issued August 2008, final maturity June 2025	32,115	4.27%	17,970	-	1,990	15,980	-	2,070	13,910	2,150
Series AJ issued July 2009, final maturity June 2039	123,985	4.86%	95,205	-	5,685	89,520	-	6,080	83,440	6,570
Series AK issued Sept. 2009, final maturity June 2024	47,310	4.00%	24,535	-	4,080	20,455	-	4,220	16,235	4,405
Series AL issued July 2010, final maturity June 2035	135,410	5.00%	74,420	-	8,000	66,420	-	5,955	60,465	6,525
Series AM issued July 2011, final maturity June 2036	119,085	4.66%	99,550	-	4,655	94,895	-	4,900	89,995	4,955
Series AN issued March 2012, final maturity June 2023	76,810	5.00%	63,130	-	9,430	53,700	-	9,705	43,995	14,400
Series AO issued July 2013, final maturity June 2038	30,915	4.44%	27,880	-	1,105	26,775	-	1,130	25,645	1,170
Series AP issued May 2014, final maturity June 2024	46,110	4.60%	40,485	-	1,200	39,285	-	1,240	38,045	1,275
Series AQ issued May 2015, final maturity June 2036	94,975	4.65%	93,095	-	6,685	86,410	-	7,480	78,930	7,855
Series AR issued Sept. 2015, final maturity June 2040	102,365	3.95%	100,545	-	2,475	98,070	-	2,595	95,475	2,725
Series AS issued June 2016, final maturity June 2037	47,280	3.83%	47,280	-	850	46,430	-	2,135	44,295	3,060
Series AT issued Sept. 2016, final maturity June 2055	298,110	3.43%	-	$298,110	4,900	293,210		7,100	286,110	7,425
Series AU issued Sept. 2017, final maturity June 2042	128,260	3.51%	-	-	-	-	$128,260	2,355	125,905	5,200
Total	**$1,524,825**		**$842,590**	**$298,110**	**$67,785**	**$1,072,915**	**$128,260**	**$165,605**	**$1,035,570**	**$74,270**

Principal and interest requirements to maturity are as follows.

(in thousands)	Principal	Interest	Total
2019	$74,270	$44,867	$119,137
2020	82,625	41,478	124,103
2021	67,825	37,645	105,470
2022	68,240	34,552	102,792
2023	69,240	31,242	100,482
2024–2028	267,245	111,236	378,481
2029–2033	188,670	60,553	249,223
2034–2038	137,055	27,238	164,293
2039–2043	70,895	7,556	78,451
2044–2048	4,710	1,652	6,362
2049–2053	3,505	865	4,370
2054–2055	1,290	89	1,379
Total	**$1,035,570**	**$398,973**	**$1,434,543**

(11) Rating Actions

The State System's outstanding bonds are assigned an Aa3 rating from Moody's Investors Service, Inc., as well as an A+ rating from Fitch Ratings, a downgrade from last year's AA- rating. In August 2018, both Moody's and Fitch revised their outlooks for the ratings from *negative* to *stable*.

(12) Deferred Outflows of Resources and Deferred Inflows of Resources

The classifications of deferred outflows of resources and deferred inflows of resources at June 30, 2018 and 2017, follow.

(in thousands)	June 30, 2018	June 30, 2017
Deferred Outflows of Resources		
Pension related (see note 7)	$146,276	$233,236
OPEB related (see note 8)	59,306	-
Unamortized loss on refunding of debt	8,821	7,872
Total Deferred Outflows of Resources	$214,403	$241,108
Deferred Inflows of Resources		
Pension related (see note 7)	$69,873	$46,340
OPEB related (see note 8)	198,704	-
Unamortized gain on refunding of debt	796	934
Split-interest agreements	10	-
Total Deferred Inflows of Resources	$269,383	$47,274

(13) Contingencies and Commitments

Contingencies

The nature of the educational industry is such that, from time to time, the State System 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.

The State System receives support from federal and Commonwealth grant programs, primarily for student financial assistance. Entitlement to the resources requires compliance with terms of the grant agreements and applicable regulations, including the expenditure of the resources for eligible purposes. Substantially all grants are subject to financial and compliance audits by the grantors. As of June 30, 2018, the State System estimates that adjustments, if any, as a result of such audits would not have a material adverse effect on the accompanying financial statements, with the exception of potential adjustments related to Cheyney University of Pennsylvania, as detailed in the following section.

Cheyney University of Pennsylvania

In November 2015, the Middle States Commission on Higher Education (Middle States) accreditation organization placed Cheyney University on probation "because of insufficient evidence that the institution is currently in compliance with Standard 3 (Institutional Resources)." Standard 3 requires, among other things, that an institution demonstrate that it has sufficient resources to support both its programs of study and students' academic progress. The university was given two years to address the deficiencies noted by Middle States. As required, the university submitted monitoring reports that documented its plan for remediation. In June 2017, Middle States required Cheyney to show cause, by September 1, 2017, as to why its accreditation should not be withdrawn, and Cheyney submitted the required documentation. In November 2017, Middle States extended Cheyney's accreditation for an additional year, noting that Cheyney had made "significant progress toward the resolution of its non-compliance issues" and is "making a good-faith effort to remedy existing deficiencies." Middle States further stated that there is "a reasonable expectation that such deficiencies will be remedied within the period of the extension" of the university's accreditation. In September 2018, Cheyney submitted a report to Middle States demonstrating its progress on the remaining accreditation issues, and a response from Middle States as to whether or not Cheyney's accreditation will be further extended is expected in November 2018.

To help the university secure continued accreditation, in August 2017, the Board approved a motion that it will forgive more than $30 million in loans, made to Cheyney from the 13 other universities and the Office of the Chancellor, if the university demonstrates fiscal stability. One-third will be forgiven when Cheyney cuts $7.5 million from its fiscal year 2017/18 budget and maintains a balanced budget for fiscal year 2018/19. The next two-thirds will be forgiven when Cheyney demonstrates a balanced budget in each of the following two fiscal years. Cheyney has advised the Board that it has successfully met the first criteria of cutting $7.5 million from its fiscal year 2017/18 budget when the expenditure cuts are viewed on an annualized basis.

In August 2015, Cheyney University voluntarily self-reported to the U.S. Department of Education (ED) that $29.6 million of federal student financial aid was improperly administered and delivered in fiscal years 2011/12, 2012/13, and 2013/14, covering almost 4,400 student records. The State System has been engaged with the ED since reporting these findings. The ED is requiring the university to take specified corrective actions, including submitting file reviews, reconciliations, and updated policies and procedures, and further requiring that Cheyney engage an independent Certified Public Accountant to attest to the file reviews and reconciliations.

In September 2015, the ED placed the university on Heightened Cash Monitoring 2 (HCM2) status, meaning that the university does not receive federal student financial aid funds in advance, but must use its own cash to grant federal financial aid to its students and then request reimbursement from the ED. After demonstrating compliance with HCM2 requirements, the university has begun to slowly receive its funds, but only after providing extensive detailed documentation for every student's financial aid account. At June 30, 2018, Cheyney was awaiting receipt of $12.38 million in federal student financial aid funds from fiscal years 2015/16, 2016/17, and 2017/18. As of the date of this document, the university had not received any funds from the ED since April 2018. The delay in receipt of funds exacerbates the university's severe cash shortage. To enable Cheyney to meet its cash needs, the Office of the Chancellor has been issuing to Cheyney interest-free short-term appropriation anticipation loans, which are paid back as monthly appropriations are received, as well as an additional $8.2 million in loans that will be paid back when the funds are received from the ED, and a $.2 million loan in anticipation of insurance proceeds.

In January 2016, the U.S. Department of Justice (DOJ) notified the State System that it was investigating the application and use of federal student financial aid by Cheyney University and the oversight of the university by the State System. The DOJ requested that the university and State System preserve and produce certain documents. The State System has fully complied and continues to comply with the DOJ's requests. No determination has yet been conveyed by the DOJ, and the possible resulting outcomes from the investigation are uncertain.

The university continues to make cuts to administration and staff and reorganize business and campus operations, and has placed some academic programs into moratorium to additionally help balance the budget and better align academic programs with the future of the university.

Insurance
The State System is self-insured for workers' compensation up to stated limits (note 5). For all other risks of loss, the State System pays annual premiums to the Commonwealth to participate in its Risk Management Program. The State System 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. The State System has not significantly reduced any of its insurance coverage from the prior year. Settled claims have not significantly exceeded the State System'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, 2018 and 2017, were approximately $57,531,000 and $52,802,000, respectively.

(14) Subsequent Events

In September 2018, PHEFA issued Series AV-1 tax-exempt revenue bonds in the amount of $102,345,000 and Series AV-2 taxable revenue bonds in the amount of $134,600,000. The net proceeds from the Series AV-1 revenue bonds were used to finance a capital project at West Chester University and to current refund Series AG and a significant portion of Series AI revenue bonds. The refunding was performed to reduce debt service by approximately $2,700,000 and resulted in an economic gain (difference between the present values of the old and new debt service payments) of $2,400,000. The net proceeds from the Series AV-2 revenue bonds were used to acquire student housing facility at Shippensburg University. In connection with the bond issuance, the State System entered into a loan agreement with PHEFA under which the State System pledged its full faith and credit for repayment of bonds.

REQUIRED SUPPLEMENTARY INFORMATION

Years Ended June 30, 2018 and 2017

(Unaudited)

Schedule of Proportionate Share of SERS Net Pension Liability (NPL)

Determined as of SERS' December 31 measurement dates

(in thousands)

Fiscal Year	State System's Proportion	State System's Proportionate Share	State System's Covered-Employee Payroll	State System's Proportionate Share of NPL as a Percentage of Covered-Employee Payroll	SERS Fiduciary Net Position as a Percentage of Total Pension Liability
2014/15	4.901%	$728,094	$296,967	245%	64.8%
2015/16	4.721%	$858,417	$297,714	288%	58.9%
2016/17	4.837%	$931,620	$300,803	310%	57.8%
2017/18	4.906%	$848,315	$309,084	275%	63.0%

SERS Schedule of Contributions

Determined as of State System's June 30 fiscal year end dates

(in thousands)

Fiscal Year	Contractually Required Contributions	Contributions Recognized by SERS	Contribution Deficiency (Excess)	Covered-Employee Payroll	Contributions as a Percentage of Covered-Employee Payroll
2014/15	$57,234	$57,234	$0	$293,506	19.50%
2015/16	$69,021	$69,021	$0	$291,594	23.67%
2016/17	$83,754	$83,754	$0	$301,828	27.75%
2017/18	$94,727	$94,727	$0	$304,575	31.10%

Schedule of Proportionate Share of PSERS Net Pension Liability (NPL)

Determined as of PSERS' June 30 measurement dates
(in thousands)

	PSERS Net Pension Liability						
Fiscal Year	**State System's Proportion**	**State System's Proportionate Share**	**Commonwealth's Proportionate Share**	**Total**	**State System's Covered-Employee Payroll**	**State System's Proportionate Share of NPL as a Percentage of Covered-Employee Payroll**	**PSERS Fiduciary Net Position as a Percentage of Total Pension Liability**
2014/15	.1785%	$70,650	$70,650	$141,350	$45,552	155%	57.2%
2015/16	.1852%	$80,220	$80,220	$160,440	$47,670	168%	54.4%
2016/17	.1833%	$90,838	$90,838	$181,676	$47,485	200%	50.1%
2017/18	.1811%	$89,442	$89,442	$178,884	$48,236	200%	51.8%

PSERS Pension Schedule of Contributions

Determined as of State System's June 30 fiscal year end dates
(in thousands)

Fiscal Year	Contractually Required Contributions	Contributions Recognized by PSERS	Contribution Deficiency (Excess)	Covered-Employee Payroll	Contributions as a Percentage of Covered-Employee Payroll
2014/15	$5,236	$5,236	$0	$51,086	10.25%
2015/16	$6,012	$6,012	$0	$48,419	12.41%
2016/17	$7,107	$7,107	$0	$49,518	14.35%
2017/18	$7,880	$7,880	$0	$50,586	15.58%

State System Plan OPEB Liability

Determined as of the June 30 measurement dates
(in thousands)

	Fiscal Year June 30, 2018
Changes in the System Plan Total OPEB Liability	
Total OPEB Liability – Beginning Balance	$1,559,134
Service Cost	48,636
Interest	39,441
Changes of Assumptions	(143,201)
Benefit Payments	(43,968)
Net Changes	(99,092)
Total OPEB Liability—Ending Balance	$1,460,042
Covered Employee Payroll	$592,245
OPEB Liability as a Percent of Covered Payroll	246.53%

Note to Schedule: *The System Plan has no assets accumulated in a trust in which the employer contributions are irrevocable, are dedicated to providing OPEB to plan members, or are legally protected from creditors.*

Schedule of Proportionate Share of the REHP Net OPEB Liability

Determined as of REHP's June 30 measurement dates
(in thousands)

Fiscal Year	State System's Proportion	State System's Proportionate Share	State System's Covered-Employee Payroll	State System's Proportionate Share of Net OPEB Liability as a Percentage of Covered-Employee Payroll	REHP's Fiduciary Net Position as a Percentage of Total OPEB Liability
2017/18	4.374%	$860,881	$117,366	733.5%	1.4%

REHP Schedule of Contributions

Determined as of State System's June 30 fiscal year end dates
(in thousands)

Fiscal Year	Contractually Required Contributions	Contributions Recognized by SERS	Contribution Deficiency (Excess)	Covered-Employee Payroll	Contributions as a Percentage of Covered-Employee Payroll
2017/18	$21,441	$21,441	$0	$141,268	15.18%

Schedule of Proportionate Share of PSERS Net OPEB Liability

Determined as of PSERS' June 30 measurement dates
(in thousands)

	PSERS Net OPEB Liability						
Fiscal Year	**State System's Proportion**	**State System's Proportionate Share**	**Commonwealth's Proportionate Share**	**Total**	**State System's Covered-Employee Payroll**	**State System's Proportionate Share of Net OPEB Liability as a Percentage of Covered-Employee Payroll**	**PSERS Fiduciary Net Position as a Percentage of Total OPEB Liability**
2017/18	.1811%	$3,690	$3,690	$7,380	$48,236	7.65%	5.73%

PSERS OPEB Schedule of Contributions

Determined as of State System's June 30 fiscal year end dates
(in thousands)

Fiscal Year	**Contractually Required Contributions**	**Contributions Recognized by PSERS**	**Contribution Deficiency (Excess)**	**Covered-Employee Payroll**	**Contributions as a Percentage of Covered-Employee Payroll**
2017/18	$204	$204	$0	$50,586	0.40%

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