

DREXEL UNIVERSITY AND SUBSIDIARIES

FINANCIAL REPORT

June 30, 2009



INDEPENDENT AUDITORS' REPORT

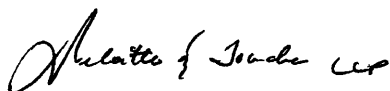
Board of Trustees
Drexel University
Philadelphia, Pennsylvania

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

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

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

Our audits were conducted for the purposes of forming an opinion on the basic consolidated financial statements taken as a whole. The supplemental consolidating schedules on pages 23-26 are presented for the purpose of additional analysis of the basic consolidated financial statements rather than to present the financial position and change in net assets of the individual entities, and are not a required part of the basic consolidated financial statements. These schedules are the responsibility of the University's management. Such schedules have been subject to the auditing procedures applied in our audits of the basic consolidated financial statements and, in our opinion, are fairly presented in all material respects when considered in relation to the basic consolidated financial statements taken as a whole.



September 22, 2009

DREXEL UNIVERSITY and SUBSIDIARIES
CONSOLIDATED STATEMENTS of FINANCIAL POSITION
as of June 30, 2009 and 2008 (in thousands)

ASSETS	<u>2009</u>	<u>2008</u>
Cash and cash equivalents:		
Operating cash	\$ 36,935	\$ 41,214
Risk Retention Group cash	4,398	3,354
Accounts receivable, net:		
Tuition	44,004	39,081
Patients	6,081	6,194
Grants, contracts and other	31,324	29,070
Tenet HealthSystem	1,530	801
Total accounts receivable, net	<u>82,939</u>	<u>75,146</u>
Contributions receivable, net	69,404	42,483
Other assets	40,903	37,608
Deposits with bond trustees	82,204	145,028
Student loans receivable, net	34,523	32,786
Beneficial interests in trusts	19,818	26,658
Investments	426,931	576,846
Land, buildings and equipment, net	546,900	446,612
Total assets	<u>\$ 1,344,955</u>	<u>\$ 1,427,735</u>
LIABILITIES		
Accounts payable	\$ 41,932	\$ 44,696
Accrued expenses	76,112	72,779
Line of credit		195
Deposits	20,625	22,745
Deferred revenue	72,560	58,292
Capital lease	3,150	
Government advances for student loans	26,199	26,151
Postretirement benefits	27,977	25,331
Bonds and notes payable	402,948	389,311
Total liabilities	<u>671,503</u>	<u>639,500</u>
NET ASSETS		
Unrestricted	326,748	401,487
Temporarily restricted	148,194	192,644
Permanently restricted	198,510	194,104
Total net assets	<u>673,452</u>	<u>788,235</u>
Total liabilities and net assets	<u>\$ 1,344,955</u>	<u>\$ 1,427,735</u>

See notes to consolidated financial statements.

DREXEL UNIVERSITY and SUBSIDIARIES

CONSOLIDATED STATEMENT of ACTIVITIES

for the year ended June 30, 2009 (in thousands)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
OPERATING REVENUE				
Tuition and fees	\$ 519,548			\$ 519,548
Less: institutional financial aid	(120,228)			(120,228)
Net student revenue	<u>399,320</u>			<u>399,320</u>
Patient care activities	86,543			86,543
State appropriations	18,274			18,274
Government grants and contracts	91,909			91,909
Private grants and contracts	13,706			13,706
Private gifts	2,534	\$ 42,644		45,178
Endowment payout under spending formula	11,940	14,768	\$ 228	26,936
Investment income	2,726	274		3,000
Sales and services of auxiliary enterprises	65,672			65,672
Other sources	20,873			20,873
Net assets released from restrictions	34,684	(34,467)	(217)	
Total operating revenue	<u>748,181</u>	<u>23,219</u>	<u>11</u>	<u>771,411</u>
OPERATING EXPENSE				
College programs	239,431			239,431
Research and public service	85,676			85,676
Academic support	21,858			21,858
Student services	35,640			35,640
Institutional support	98,474			98,474
Scholarships and fellowships	17,234			17,234
Auxiliary enterprises	34,019			34,019
Total education and general	<u>532,332</u>			<u>532,332</u>
Patient care activities	104,499			104,499
Operation and maintenance	47,218			47,218
Interest	15,781			15,781
Depreciation	26,702			26,702
Total operating expense	<u>726,532</u>			<u>726,532</u>
Change in net assets from operating activities	<u>21,649</u>	<u>23,219</u>	<u>11</u>	<u>44,879</u>
NON-OPERATING ACTIVITY				
Endowment and other gifts			9,430	9,430
Realized/unrealized loss on investments, net of endowment payout of \$21,353	(82,747)	(67,669)	(5,035)	(155,451)
Other non-operating expense	(13,641)	-		(13,641)
Change in net assets from non-operating activities	<u>(96,388)</u>	<u>(67,669)</u>	<u>4,395</u>	<u>(159,662)</u>
Change in net assets	<u>(74,739)</u>	<u>(44,450)</u>	<u>4,406</u>	<u>(114,783)</u>
Net assets at beginning of year	<u>401,487</u>	<u>192,644</u>	<u>194,104</u>	<u>788,235</u>
Net assets at end of year	<u>\$ 326,748</u>	<u>\$ 148,194</u>	<u>\$ 198,510</u>	<u>\$ 673,452</u>

See notes to consolidated financial statements.

DREXEL UNIVERSITY and SUBSIDIARIES

CONSOLIDATED STATEMENT of ACTIVITIES

for the year ended June 30, 2008 (in thousands)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
OPERATING REVENUE				
Tuition and fees	\$ 472,010			\$ 472,010
Less: institutional financial aid	(111,137)			(111,137)
Net student revenue	<u>360,873</u>			<u>360,873</u>
Patient care activities	83,415			83,415
State appropriations	18,806			18,806
Government grants and contracts	89,894			89,894
Private grants and contracts	14,367			14,367
Private gifts	4,174	\$ 35,222		39,396
Endowment payout under spending formula	10,365	14,453	\$ 216	25,034
Investment income	6,359	5,082		11,441
Sales and services of auxiliary enterprises	59,516			59,516
Other sources	19,320			19,320
Net assets released from restrictions	30,135	(30,135)		
Total operating revenue	<u>697,224</u>	<u>24,622</u>	<u>216</u>	<u>722,062</u>
OPERATING EXPENSE				
College programs	228,330			228,330
Research and public service	85,495			85,495
Academic support	19,425			19,425
Student services	33,261			33,261
Institutional support	84,181			84,181
Scholarships and fellowships	16,396			16,396
Auxiliary enterprises	32,347			32,347
Total education and general	<u>499,435</u>			<u>499,435</u>
Patient care activities	97,141			97,141
Operation and maintenance	41,967			41,967
Interest	15,846			15,846
Depreciation	25,132			25,132
Total operating expense	<u>679,521</u>			<u>679,521</u>
Change in net assets from operating activities	<u>17,703</u>	<u>24,622</u>	<u>216</u>	<u>42,541</u>
NON-OPERATING ACTIVITY				
Endowment and other gifts			4,746	4,746
Realized/unrealized loss on investments, including endowment payout of \$18,322	(37,257)	(54,836)	(2,239)	(94,332)
Other non-operating expense	(7,627)			(7,627)
Change in net assets from non-operating activities	<u>(44,884)</u>	<u>(54,836)</u>	<u>2,507</u>	<u>(97,213)</u>
Change in net assets	<u>(27,181)</u>	<u>(30,214)</u>	<u>2,723</u>	<u>(54,672)</u>
Net assets at beginning of year	<u>428,668</u>	<u>222,858</u>	<u>191,381</u>	<u>842,907</u>
Net assets at end of year	<u><u>\$ 401,487</u></u>	<u><u>\$ 192,644</u></u>	<u><u>\$ 194,104</u></u>	<u><u>\$ 788,235</u></u>

See notes to consolidated financial statements.

DREXEL UNIVERSITY and SUBSIDIARIES

CONSOLIDATED STATEMENTS of CASH FLOWS

for the years ended June 30, 2009 and 2008 (in thousands)

	<u>2009</u>	<u>2008</u>
CASH FLOW FROM OPERATING ACTIVITIES		
Decrease in net assets	\$ (114,783)	\$ (54,672)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	26,702	25,132
Disposals of property and equipment	336	218
Decrease in beneficial interests in trusts	6,840	2,651
Contributions for long-term investment	(9,430)	(4,746)
Actuarial change on annuity liabilities	1,165	(511)
Realized/unrealized loss on investments	155,451	94,332
Changes in operating assets and liabilities:		
Accounts receivable, net	(7,793)	(8,951)
Contributions receivable, net	(26,921)	(11,132)
Accounts payable and accrued expenses	(270)	10,818
Postretirement benefits	2,646	212
Other assets	(3,295)	(4,845)
Deposits and deferred revenue	12,148	6,157
	<hr/>	<hr/>
Net cash provided by operating activities	42,796	54,663
	<hr/>	<hr/>
CASH FLOW FROM INVESTING ACTIVITIES		
Purchase of investments	(348,628)	(242,053)
Proceeds from sale of investments	343,092	217,383
Proceeds from student loan collections	3,982	10,080
Student loans issued	(5,719)	(10,769)
Purchase of land, buildings and equipment	(123,840)	(40,000)
Deposits placed with bond trustees		(144,320)
Use of deposits with bond trustees	62,824	14,367
	<hr/>	<hr/>
Net cash used in investing activities	(68,289)	(195,312)
	<hr/>	<hr/>
CASH FLOW FROM FINANCING ACTIVITIES		
Contributions restricted for endowments	9,430	4,746
Payments on annuity obligations	(662)	(764)
Government advances for student loans	48	451
Proceeds from long-term borrowings	20,000	149,206
Repayment of short-term debt	(195)	(4,679)
Repayment of long-term debt	(6,363)	(12,519)
	<hr/>	<hr/>
Net cash provided by financing activities	22,258	136,441
	<hr/>	<hr/>
Net decrease in cash and cash equivalents	(3,235)	(4,208)
Cash and cash equivalents at beginning of year	44,568	48,776
	<hr/>	<hr/>
Cash and cash equivalents at end of year	\$ 41,333	\$ 44,568
	<hr/>	<hr/>
SUPPLEMENTAL INFORMATION		
Gifts in kind	\$ 163	\$ 533
Cash paid for interest	\$ 16,015	\$ 14,830

See notes to consolidated financial statements.

DREXEL UNIVERSITY and SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
for the Years Ended June 30, 2009 and 2008

Note 1: Summary of Significant Accounting Policies

Basis of Financial Statements: Drexel University (the "University") is a private research university located in Philadelphia, Pennsylvania. The University is an exempt organization under Section 501 (c) (3) of the Internal Revenue Code. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for not-for-profit organizations. Under these principles, contributions or unconditional promises to give are recognized as revenues in the period received at their net present value, less an allowance for uncollectible pledges. Resources are reported for accounting purposes in separate classes of net assets based on the existence or absence of donor-imposed restrictions. In the accompanying financial statements, net assets that have similar characteristics have been combined into similar categories as shown below.

Permanently restricted: Net assets subject to donor-imposed stipulations that they be maintained permanently by the University. Generally, the donors of these assets permit the University to use all or part of the income earned on these assets. Such assets are included in the University's permanent endowment funds.

Temporarily restricted: Net assets whose use by the University is subject to donor-imposed restriction that can be fulfilled by actions of the University in accordance with those stipulations or by the passage of time, including the following:

Endowment income and contributions with donor-imposed restrictions are reported as temporarily restricted and are reclassified to unrestricted net assets when the donor-imposed restrictions have been met.

The University utilizes endowment gains under a spending formula, subject to certain limitations. Since endowment net realized and unrealized gains may eventually be spent by the University, these gains are recorded in the financial statements as temporarily restricted net assets until transferred to unrestricted net assets.

Unrestricted: Net assets that are not subject to donor-imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of the Board of Trustees or may otherwise be limited by contractual agreements with outside parties. Expenses are generally reported as decreases in unrestricted net assets. Expirations of donor-imposed stipulations are reported as net assets released from restrictions. Gains and losses on investments are reported as increases or decreases in unrestricted net assets unless explicit donor stipulation or law restricts their use.

All revenues received and expenditures paid prior to the end of the fiscal year which relate to the following fiscal year are recorded and reflected as deferred revenues and deferred charges, respectively.

Note 1: Summary of Significant Accounting Policies, continued...

Philadelphia Health & Education Corporation: The University owns 100% of the Philadelphia Health & Education Corporation, doing business as Drexel University College of Medicine ("PHEC"). PHEC is party to an Academic Affiliation Agreement with Tenet HealthSystem Philadelphia, Inc. ("Tenet") intended to establish a relationship to foster continued coordination and integration between PHEC and the Tenet hospitals. This agreement, dated November 10, 1998 and subsequently amended on April 25, 2002, is effective until June 30, 2022 and may be renewed thereafter for separate and successive five-year terms. Under the terms of the agreement, PHEC commits to furnish administrative, supervisory, and teaching services to Tenet at budgeted levels through June 30, 2022 (see Note 12).

In addition, PHEC has agreed to provide teaching and administrative services for the education of the University's medical students in accordance with an agreement, which renews annually, that is effective until June 30, 2010. PHEC has also engaged the University to provide service and personnel for its administrative and academic operations.

Academic Properties, Inc.: The University owns 100% of Academic Properties, Inc. ("API"), a tax-exempt organization. API manages properties utilized by the University as well as other strategically located properties contiguous to the campus. The balances and activities of API are consolidated in the University's financial statements.

Drexel e-Learning, Inc.: The University owns 100% of the issued and outstanding stock of Drexel e-Learning, Inc. ("DeL"). DeL was created to provide educational products and services through distance learning. The balances and activities of DeL are consolidated in the University's financial statements.

Cash and Cash Equivalents: Cash and cash equivalents represent demand deposits and other investments with an initial maturity date not exceeding 90 days.

Beneficial Interests in Trusts: Gifts held by outside trustees for whom the University has a beneficial interest are recorded at the present value of expected future cash flows as unrestricted, temporarily and permanently restricted net assets and related beneficial interests in trusts in the consolidated financial statements.

Accounting for Derivative Instruments and Hedging Activities: The University entered into a fixed-to-variable interest rate swap agreement with Bank of America, N.A. ("Bank") that converts \$18,000,000 of the University's fixed rate term bonds (4.80%) to a USD floating rate obligation based on the BMA Municipal Swap Index. For fiscal year 2008, the agreement resulted in a gain on investments of \$5,000 reported in the consolidated statement of activities. During 2008, the Bank exercised its right to terminate the agreement.

The University has entered into a variable-to-fixed swap agreement with Wachovia Bank, N.A. that converts the Series B of 2005 bonds to a fixed interest rate of 3.414% through the maturity of the bonds. The agreement resulted in losses of \$1,915,000 and \$1,984,000 in 2009 and 2008, respectively, reported as an unrealized loss on investments in the consolidated statement of activities. The estimated fair value of the agreement was (\$2,196,000) and (\$281,000), respectively, at June 30, 2009 and 2008.

Note 1: Summary of Significant Accounting Policies, continued...

During fiscal year 2009, the University entered into a variable-to-fixed swap agreement with TD Bank, N.A., which converts the TD Bank loan to a fixed rate of 3.83% through the January 2014 termination date. The agreement resulted in a loss of \$120,000, reported as an unrealized loss on investments in the consolidated statement of activities. The estimated fair value of the agreement was (\$120,000) at June 30, 2009.

Fair Value of Financial Instruments: A reasonable estimate of the fair value of student loans receivable under government loan programs and refundable federal student loans could not be made because the loans are not readily saleable. These loans are recorded at cost, less an allowance for doubtful accounts. See Notes 4, 5 and 8 for additional fair value disclosures.

Patient Care Activities: PHEC faculty physicians participate in several physician practice plans that are managed by PHEC. Revenue and expenses related to these practice plans are recorded as patient care activities.

Patient care activities represent amounts received and the estimated net realizable amounts due from patients and third-party payers for services rendered. PHEC provides care to patients under various reimbursement arrangements, including Medicare and Medicaid. These arrangements provide for payment for covered services at agreed-upon rates and under certain fee schedules and various discounts from charges. Provisions have been made in the consolidated financial statements for estimated contractual adjustments, representing the difference between the customary charges for services rendered and related reimbursement. In 2009 and 2008, revenue from Medicare and Medicaid programs combined and from managed care payers accounted for 18% and 54%, respectively, and 18% and 53%, respectively, of gross patient service revenue.

Schuylkill Crossing Reciprocal Risk Retention Group: The Schuylkill Crossing Reciprocal Risk Retention Group (the "RRRG") operates to provide primary coverage for claims-made medical professional liability insurance for health care professionals employed by PHEC. Ownership of the RRRG is split 87%/13% between PHEC and the University, respectively.

At June 30, 2009, the assets and ownership equity of the RRRG amounted to \$38,683,000 and \$3,052,000, respectively, and revenues and expenses for the year then ended were \$1,024,000 and \$2,404,000, respectively. At June 30, 2008, the assets and ownership equity of the RRRG amounted to \$31,205,000 and \$2,747,000, respectively, and revenues and expenses for the year then ended were \$1,053,000 and \$1,038,000, respectively. The balances and activities of the RRRG are included in the accompanying consolidated financial statements.

Non-operating Activities: Non-operating activities include contributions restricted for endowment, losses on investments in excess of payouts under the endowment spending policies, claims related to PHEC, loss on the disposal of equipment, postretirement benefit adjustment, severances and start-up costs for the Drexel College of Law and the Sacramento campus.

Reclassifications: Certain scholarship and information technology expenses in the 2008 consolidated statement of activities have been reclassified from instruction and institutional support to scholarships and patient care activities to conform to the 2009 classifications and comply with regulatory filing requirements.

Note 1: Summary of Significant Accounting Policies, continued...

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 amount of assets and liabilities and disclosure 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.

Adoption of New Accounting Pronouncements: In February 2007, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which permits organizations to measure certain financial instruments and certain other items at fair value. SFAS No. 159 was effective for the University on July 1, 2008. The University has adopted the fair value option for contributions receivable under the provisions of SFAS No. 159. See Note 5 for the fair value of investments.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*. SFAS No. 161 requires organizations with derivative instruments to disclose how and why derivative instruments are used, how derivative instruments and related hedged items are accounted for under SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities*, and how derivative instruments and related hedged items affect an organization's financial statements. SFAS No. 161 is effective for financial statements issued for the University as of June 30, 2010. The University does not anticipate that the adoption of this statement will have a material impact on its consolidated financial statements.

Note 2: Net Assets

Net assets consist of the following:

	(in thousands)	
	2009	2008
Unrestricted:		
Undesignated	\$ (164,471)	\$ (124,458)
Designated for:		
Colleges, departments and student loans	79,040	66,355
Physical plant	262,073	235,514
Quasi-endowment funds	166,870	224,076
Reclassification for endowments with deficiencies	(16,764)	
Total unrestricted	326,748	401,487
Temporarily restricted:		
Funds for instruction, scholarships and capital expenditures:		
Unexpended	99,622	93,756
Endowment realized and unrealized gain	24,332	91,416
Reclassification for endowments with deficiencies	16,764	
Life income and term endowment funds	7,476	7,472
Total temporarily restricted	148,194	192,644
Permanently restricted:		
Endowment principal	176,288	167,219
Beneficial interests in trusts	16,135	20,925
Student loans and others	6,087	5,960
Total permanently restricted	198,510	194,104
Total net assets	\$ 673,452	\$ 788,235

Note 3: Receivables

Accounts and loans receivable, net of allowances, are follows:

	(in thousands)	
	2009	2008
Patients, net of contractual allowances	\$ 11,000	\$ 12,544
Tuition	49,543	44,803
Grants, contracts and other	32,430	30,148
Tenet HealthSystem	1,530	801
	<u>94,503</u>	<u>88,296</u>
Less allowance for doubtful accounts	(11,564)	(13,150)
Net accounts receivable	<u>\$ 82,939</u>	<u>\$ 75,146</u>
Student loans receivable	\$ 37,549	\$ 35,589
Less allowance for doubtful accounts	(3,026)	(2,803)
Net student loans receivable	<u>\$ 34,523</u>	<u>\$ 32,786</u>

Note 4: Contributions Receivable

Net contributions receivable at June 30 consist of the following:

	(in thousands)	
	2009	2008
Amounts due in:		
Less than one year	\$ 15,932	\$ 5,516
One to five years	36,688	26,546
Greater than five years	29,908	26,153
Gross contributions receivable	<u>82,528</u>	<u>58,215</u>
Less:		
Allowance for uncollectibles	(1,190)	(2,278)
Discounts to present value	(11,934)	(13,454)
Total contributions receivable, net	<u>\$ 69,404</u>	<u>\$ 42,483</u>

The current yields for two-to ten year U.S. Treasury notes are used to discount contributions receivable, which averaged 2.292% and 3.375% for the fiscal years ended June 30, 2009 and 2008, respectively. The University considers these yields to be a Level 3 input in the context of the SFAS No. 157 hierarchy (see Note 5).

Outstanding conditional promises to give to the University totaled \$9,987,000 and \$11,597,000 at June 30, 2009 and 2008, respectively, which are dependent upon the fulfillment of certain conditions and, therefore, are not included in the consolidated financial statements.

Note 4: Contributions Receivable, continued...

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

	(in thousands)
Net contributions receivable, beginning of year	\$ 42,483
New pledges	35,570
Collections on pledges	(11,257)
Decrease in allowance for uncollectibles	1,088
Decrease in present value discounts	1,520
Net contributions receivable, end of year	\$ 69,404

Note 5: Investments

Effective July 1, 2008, the University implemented SFAS No. 157, *Fair Value Measurements* that defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 clarifies that fair value should be based on assumptions about risk, risks inherent in valuation techniques and the inputs to valuations. SFAS No. 157 also requires fair value measurements to assume that the transaction occurs in the principal market for the asset or liability (the market with the most volume and activity for the asset or liability from the perspective of the reporting entity), or in the absence of a principal market, the most advantageous market for the asset or liability (the market in which the reporting entity would be able to maximize the amount received or minimize the amount paid). The University applies fair value measurements to contributions receivable, beneficial interests in trusts, endowment investments, self-insurance escrow funds, real estate and interest rate swaps.

In accordance with SFAS No. 157, the University maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. Fair value is based on actively-quoted market prices, if available. In the absence of actively-quoted market prices, price information from external sources, including broker quotes, and industry publications is used. If pricing information from external sources is not available, or if observable pricing is not indicative of fair value, judgment is required to develop the estimates of fair value. In those cases, prices are estimated based on available historical financial data or comparable investment vehicles that reflect widely accepted market valuation practices.

SFAS No. 157 requires fair value measurements to be disclosed by level within the fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable data (Level 3). In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. In those cases, the lowest level input that is significant to a fair value measurement in its entirety determines the applicable level in the fair value hierarchy. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment and consideration of factors specific to the asset. Fair value measurements are categorized as Level 3 when a significant amount of price or other inputs, considered to be unobservable, are used in their valuations. The change in net assets in the Level 3 category is a required disclosure and is shown below. The fair value hierarchy and inputs to valuation techniques are as follows:

Note 5: Investments, continued...

Level 1 - Quoted prices (unadjusted) in active markets for identical assets and liabilities at the measurement date. Instruments categorized in Level 1 primarily consist of a broadly-traded range of equities and debt securities.

Level 2 - Inputs other than quoted prices included within Level 1 that are either directly or indirectly observable for the asset or liability, including quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability, and inputs that are derived from observable market data by correlation or other means. Instruments categorized in Level 2 primarily include non-exchange-traded fixed income securities, structured products, interest rate swaps, certain bond investments and real estate.

Level 3 - Unobservable inputs for the asset or liability, including situations where there is little, if any, market activity for the asset or liability. Instruments categorized in Level 3 consist of partnership investments in hedge funds and alternative and private equities.

As of June 30, 2009, the assets measured at fair value for each hierarchy level are as follows:

	Fair Value Measurements (in thousands) Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets at Fair Value:				
Beneficial interests in trusts	\$ 19,818	\$ 19,818		
Investments held in endowment	393,142	275,503	\$ 61,795	\$ 55,844
Self-insurance escrow funds (Note 10)	7,775	7,775		
RRRG guaranteed investment contract (Note 10)	4,094	4,094		
Real estate	21,920		21,920	
Interest rate swaps (Note 1)	(2,316)		(2,316)	
Total assets	\$ 444,433	\$ 307,190	\$ 81,399	\$ 55,844

Investments held in endowment include the following: Level 1 - \$186,588,000 in equity securities, \$36,590,000 in fixed income/bond funds, \$12,270,000 in real estate and real assets, \$40,055,000 in money market funds; Level 2 - \$5,001,000 in fixed income/bond funds, \$56,794,000 in real estate and real assets; Level 3 - \$50,935,000 in alternative investments, \$4,909,000 in real estate and real assets.

The net change in the assets included in the Level 3 fair value category for the year ended June 30, 2009 is as follows:

	(in thousands)
Balance at June 30, 2008	\$ 44,593
Total losses (realized/unrealized) included in changes in net assets	(11,210)
Purchases, issuances and liquidations	22,461
Balance at June 30, 2009	\$ 55,844

Total losses for the period included in changes in net assets that are attributable to the change in unrealized losses relating to assets still held at the reporting date was (\$14,382,000) at June 30, 2009.

Note 5: Investments, continued...

Endowment – Effective June 30, 2009, the University adopted FASB Staff Position (“FSP”) No. 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act (“UPMIFA”), and Enhanced Disclosures for All Endowment Funds*. This FSP provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization whether or not it is subject to an enacted version of the UPMIFA for the purpose of improving disclosures about both donor-restricted and board-designated endowment funds. The Commonwealth of Pennsylvania has not enacted UPMIFA as of the date of this report.

Funds with Deficiencies – From time to time due to unfavorable market fluctuations, the fair value of some assets associated with individual donor-restricted endowment funds may fall below the level that donors require to be retained as a perpetual fund, while other assets are unaffected to the same extent and maintain or exceed the level required. In accordance with generally accepted accounting principles, the aggregate amount of deficiencies at June 30, 2009 was \$16,764,000, reported in unrestricted net assets in the consolidated statement of activities. Subsequent investment gains will be used to restore the balance up to the fair market value of the original gift. Subsequent gains above that amount will be recorded as temporarily restricted net assets. Aggregate deficiencies as of June 30, 2008 amounted to \$483,000.

Interpretation of Relevant Law – The Board of Trustees of the University has interpreted Pennsylvania Act 141 (PA Act 141) as requiring the preservation of the fair value of the original gift as specified in the individual trust instruments. As a result of this interpretation, the University classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instruments at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by PA Act 141.

Endowment net asset composition by type of fund as of June 30, 2009 and 2008 is as follows.

	(in thousands)			
<u>2009</u>	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ 11,433	\$ 44,925	\$ 176,288	\$ 232,646
Board-designated endowment funds	146,996	16,083		163,079
Total Net Assets	\$ 158,429	\$ 61,008	\$ 176,288	\$ 395,725
<u>2008</u>				
Donor-restricted endowment funds	\$ 37,096	\$ 111,619	\$ 167,219	\$ 315,934
Board-designated endowment funds	195,814	15,223		211,037
Total Net Assets	\$ 232,910	\$ 126,842	\$ 167,219	\$ 526,971

Board-designated temporarily restricted endowment funds represent donor-restricted funds which the Board has earmarked for endowment purposes. The earnings on these funds are utilized by the University in a manner consistent with specific donor restrictions on the original contributions.

