Financial Report

2002

Penn
University of Pennsylvania

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Penn At-A-Glance

Students Enrollment
(full-time equivalent)
Undergraduate students 11,638
Graduate & professional students 9,904

Undergraduate Admission Statistics
Applications 18,784
Percent accepted 21.0%
Percent matriculated 62.1%

Faculty
Standing faculty 2,257
Associated faculty 2,062
Total 4,319

Financial (thousands of dollars)
Total operating revenue $3,351,370
Total operating expenditures $3,310,930

Principal sources of total revenue
Tuition and fees (net) $453,824
Sponsored programs $579,727
Hospitals and physician practices $1,754,159
Contributions $296,393
Investment income $148,367

Principal purposes of expenditures
Instruction $625,005
Research $486,474
Hospitals and physician practices $1,714,078

Endowment
Market Value $3,393,297
One-year endowment performance 0.1%

Net Assets
Unrestricted $2,574,503
Temporarily restricted $1,174,929
Permanently restricted $1,406,839

Note: Student, admission and faculty statistics are for the 2002 admission cycle; financial statistics are for fiscal year 2002 (year ending June 30, 2002)

Strategic Planning

While the term "strategic planning" may sound abstract, in fact the planning process embodies our collective effort to answer a set of fundamental questions: given our historic mission and purposes, what specific goals do we set for ourselves in the years ahead? Penn and the nation's other great universities play a singular and distinctive role in shaping the future of society, in this country and around the world. Universities are institutions with long histories, whose shared mission entails a complex and continuing act of negotiation between the old and the new, conserving, interpreting, and transmitting mankind's legacy of intellectual and cultural achievement while at the same time adding to that store by producing and transmitting new knowledge.

Strategic planning is the organized effort we make to examine our aspirations, articulate our goals, identify our strengths and weaknesses, and set our priorities. It does not necessarily involve re-invention, radical change, or right-angle turns: Penn is already a place of immense achievement across a broad horizon. Rather, the planning process offers a periodic opportunity for all of the University's stakeholders—faculty, students, trustees, administration—to take stock, to challenge and inspire each other, to develop a strategy, and ultimately to choose among diverse objectives. In approaching this task, we are guided and energized not only by the concrete achievements of the past seven years, but also by the rich legacy of our predecessors and the enormous institutional strengths they have bequeathed to us.

From its founding, Penn has chosen a distinct path in higher education, its character in large part shaped by the practical genius of Benjamin Franklin. Franklin called for an institution that would link the theoretical and the applied—or, as he put it, the "ornamental and the useful"—while promoting service to "mankind, country, friends and family." With its emphasis on the liberal arts and sciences, the curriculum of the early College of Philadelphia differed substantially from that of the other colonial colleges of the time, offering students new fields of study such as modern literature, political science, applied mathematics, history, and physics.

The contemporary University of Pennsylvania is a direct descendant of its colonial forebear. The central role of the liberal arts and sciences is matched by Penn's many excellent professional and graduate schools, which have helped to shape its modern-day character and global reputation.

Achieving Excellence 1995–2002

In the fall of 1995, the University of Pennsylvania articulated its commitment to become one of the premier research and teaching universities in the nation and the world. With this goal in mind, the University initiated a planning process of which the strategic plan, ***Agenda for Excellence***, was the first step, followed by the publication of Six Academic Priorities, diversity priorities and school strategic plans the following year. Our success in achieving the goals and priorities laid out in these documents is as follows:

- Penn's academic rankings have risen;
- Student selectivity has improved;
- Faculty accomplishments and recognition have increased;
- Research funding has dramatically expanded;
- Administrative restructuring has yielded greater efficiency and effectiveness;
- Revitalization of the West Philadelphia community has accelerated; and
- Our fundraising efforts have strengthened considerably.

Building on Excellence

In fiscal year 2002, the University completed a new strategic plan entitled ***Building on Excellence: The Leadership Agenda*** which builds on many of the successes of ***The Agenda for Excellence***. Below is a summary of the current plan's objectives:

Academic Excellence: Enhance our academic excellence and solidify Penn's position as one of the premier research and teaching institutions in the nation and in the world.

- Build and retain an outstanding faculty.
- Sustain excellence in all undergraduate education programs, while building on those unique aspects that differentiate Penn among its peers.
- Strengthen the quality and national visibility of graduate Ph.D. education across all of Penn's schools.
- Sustain and enhance the excellence of Penn's professional schools.
- Improve the quality, impact, visibility, and translatability of Penn's academic research and scholarly activity.

Academic Priorities - Capitalizing on Differentiating Strengths: Build upon our special strengths to develop five selected academic priorities that will differentiate Penn among international research universities of the first rank.

- The Urban Community: As one of the nation's premier academic institutions, Penn can and should be a nationally recognized leader in urbanism.
- The Life Sciences: Building upon our unique resources, we must seize the opportunity to differentiate ourselves from our peers in the critical and rapidly moving area of life sciences research.
- Technology Innovation: Penn must be a leader in the application of technology, in the development of new technology, and in the technological education of its students.
- The Global Opportunity: In order to develop a coherent global strategy for the University, we must leverage and enhance our distinctive strengths as an international institution.
- Arts, Humanities and Society: In order to capitalize on our academic strengths in the humanities and our unique cultural resources, Penn must build an infrastructure that supports innovative, interdisciplinary cultural programs and curricular development.

Defining the Future of Education: Adapt our pedagogical methods and our student and alumni offerings to the learning needs of current and future generations

- Encourage the innovative use of educational technology to enhance teaching and learning.
- Develop a continuum of educational opportunities that engages learners throughout their lives and in various stages of their careers.
- Selectively identify new products and new markets of learners.
- Encourage the reconnection of our alumni to Penn and one another.

Creating the Capacity for Success: Develop the physical, financial, operational, and entrepreneurial capacities to sustain our academic enterprise

- Encourage and support entrepreneurial activity.
- Create a physical environment supportive of the academic and research missions of the University, both on campus and in its surrounding environment.
- Build and enhance the University's financial capacities.
- Enhance the University's operational capacities.

Message from the Vice President for Finance and Treasurer

Uncertainty marked the global landscape in fiscal year 2002. While the possibility of continued economic weakness and market volatility was widely forecasted, no one could have foreseen the 9/11 tragedies and the worldwide political turmoil that followed. Despite this environment, we were able to achieve positive financial performance in both the Academic and Health Services Components of the University. For the year, consolidated University net assets increased by $125.6 million to a total of almost $5.2 billion as of June 30, 2002.

The Academic Component experienced double-digit growth in sponsored program revenue (principally in the School of Medicine) and contributions, resulting in a positive operating surplus and an increase in net assets. Once again, Penn advanced in the annual *U.S. News & World Report* rankings of colleges and universities. The University's rank has steadily improved over the years, moving from 16th in 1994 to 4th in the most recent rankings. Student quality and demand indicators continued to trend positively, as reflected by a further reduction in the percentage of applicants accepted and an increase in the percentage of matriculants. The average SAT score for incoming freshmen advanced above the 1400 level for the 2002-2003 academic year.

The Health Services Component continued its recent favorable financial trends, achieving a positive operating margin for the second consecutive year since commencing its financial recovery program in fiscal year 2000. This result was in part due to favorable payment rates and utilization trends, which saw growth in inpatient activity, ambulatory surgeries and outpatient visits. As in previous years, the Hospital of the University of Pennsylvania was once again named to the Honor Roll of American hospitals by *U.S. News & World Report*, one of only 17 hospitals in the country so named.

In fiscal year 2002, due to the increasing stabilization of the Health Services Component's financial profile, Moody's Investors Service revised its outlook of the University from "negative" to "stable" and confirmed the "A1" rating on its outstanding long term debt. In addition, Standard & Poor's reaffirmed its "AA" rating with a "stable" outlook.

The impact of the 9/11 tragedy, along with numerous corporate scandals, wreaked havoc on the financial markets. The University's endowment performed well in this volatile climate achieving a positive return, vastly exceeding its benchmark. This positive endowment performance placed the University in the top quartile of endowments over $1 billion.

Significant capital expenditures were incurred in fiscal year 2002 in support of the University's strategic initiatives. During fiscal year 2002, the University saw the completion of several facilities that supported these objectives, including Huntsman Hall, the centerpiece of Wharton's growing global campus, and the Sadie Tanner Mossell Alexander University of Pennsylvania Partnership School, which was completed in partnership with the School District of Philadelphia.

6 Ivy League Championships in 2002

All-American Athletes

10 Members of the National Academy of Engineering

National Medal of Science recipients

7 MacArthur Award recipients

12 Graduate and professional schools

Fiscal Year 2002 Performance Highlights

The Academic Component of the University achieved a positive increase in net assets from operating activities of $17.8 million. Total net assets increased by $92.0 million due principally to non-operating contributions, most notably a $100 million gift from the Annenberg Foundation. Despite the strong revenue gains, growth in net assets from operating activities were muted by increases in operating expenses, principally employee benefit costs, which increased 27% over fiscal year 2001 levels. The benefits plan redesign implemented in fiscal year 2002, effective for fiscal year 2003, should help reduce the rate of growth of medical care costs. The University also worked diligently to control its operating costs through successful conservation efforts and the refinancing of a portion of its long term debt for interest savings.

The Health Services Component achieved an excess of revenue over expenses from operations totaling $27.3 million, which increased from the prior fiscal year by $2.2 million. This result was achieved in large part due to favorable payment rates and utilization trends, which saw growth in inpatient activity, ambulatory surgeries, and outpatient visits.

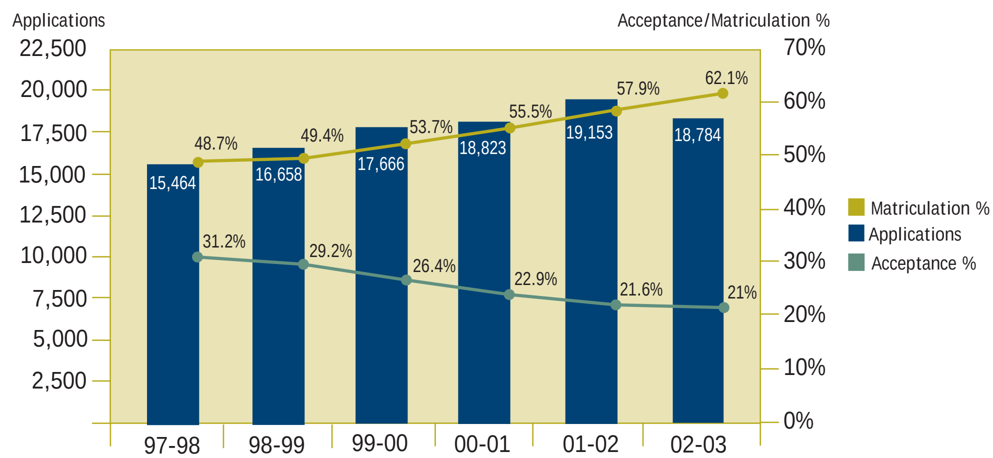
Tuition, Fees, and Financial Aid

The University recorded an increase in tuition and fee revenue of $20.7 million to $453.8 million. These amounts are net of financial aid direct grants. This represents an increase of 4.8% over fiscal year 2001.

Penn continues its need-blind undergraduate admission policy by continuing to meet the full financial aid needs of undergraduates. Increased emphasis on fund-raising for undergraduate aid has resulted in notable success. In the five-year fiscal period 1997-2002, financial aid from endowment funds increased by 135%, while funding from general funds increased by only 53%. During the same period, the average direct grant to aided freshmen rose by 32%, while the average loan fell by 21%.

For the 2002-2003 academic year, the University received 18,784 applications. The number of early decision applications grew to 3,037, also a new record, as a greater number of high school seniors continue to make Penn their first choice. The percent of applicants admitted to Penn declined to 21.0% from 21.6% the prior academic year, while the percentage of students offered admission who matriculated grew to 62.1% from 57.9%. The average SAT score for the incoming freshman class grew to 1418, up from 1392 in the prior year.

Demand and Selectivity Reaches New Heights...



Penn by the Numbers

39 Members of the National Academy of Sciences

49 Members of the Institute of Medicine

61 Members of the Academy of Arts and Sciences

65 Study-abroad programs offered

94 Guggenheim Fellowships (1980-2002)

157 Research centers and institutes

151 Academic buildings on the West Philadelphia campus

269 West Philadelphia campus acreage

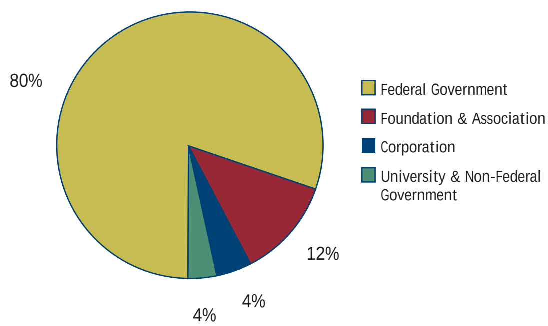
Sponsored Programs

Sponsored program activity provides over 17% of the University's total revenue. Sponsored program support includes the direct and indirect costs of sponsored research activity. Sponsored program revenue totaled $579.7 million, an increase of over $76 million, or 15.2%, compared to the prior fiscal year. The indirect cost component increased by $17.9 million to $143.8 million, an increase of 14.2%.

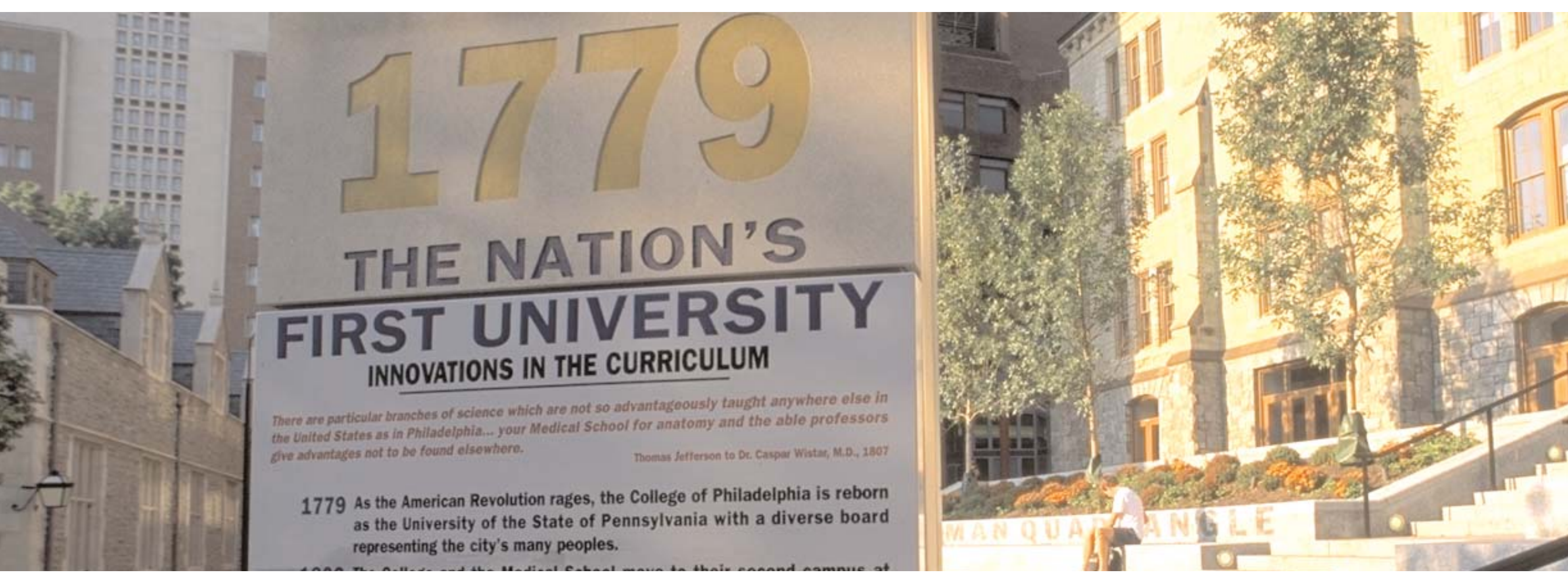
Total awards reached nearly $651 million, an 18% increase from last year's record of $551 million. Awards from the Department of Health and Human Services, including the National Institutes of Health (NIH), Penn's largest sponsor, for research, training, fellowship, and other programs totaled nearly $399 million. The University ranks second in NIH funding for the latest available federal fiscal year (fiscal year 2001). Penn had two departments ranked first in NIH funding: Dermatology and Radiology, which combines the departments of Radiology and Radiation Oncology. Nine other departments were ranked in the top five: Genetics, Medicine, Neurology, Obstetrics and Gynecology, Ophthalmology, Orthopedic Surgery, Pathology and Laboratory Medicine, Physiology, and Psychiatry.

One example of how Penn research touches our every day lives is illustrated in a study by the Tobacco Use Research Center of the University of Pennsylvania School of Medicine. Researchers found that smokers with a specific genetic variant are more vulnerable to cigarette cravings and relapse from smoking cessation. By identifying these genetic factors, researchers hope to aid in the development of more effective treatment strategies that are tailored to individual smokers.

Federal Government Awards Provide the Majority of Sponsored Program Funding...



Penn's research efforts were highlighted with the awarding of the Nobel Prize to Penn Professor Raymond Davis, Jr. and collaborators from the University of Tokyo and Johns Hopkins University, in recognition of their research into the emission of neutrinos produced by nuclear fusion reactions in the center of the sun. The observation of these neutrinos demonstrated conclusively that the sun is powered by the fusion of hydrogen nuclei into helium nuclei. Earlier this year, Professor Davis also received the 2001 National Medal of Science.



Penn
by the
Numbers

1,029 Post-doctoral fellows (approx.)

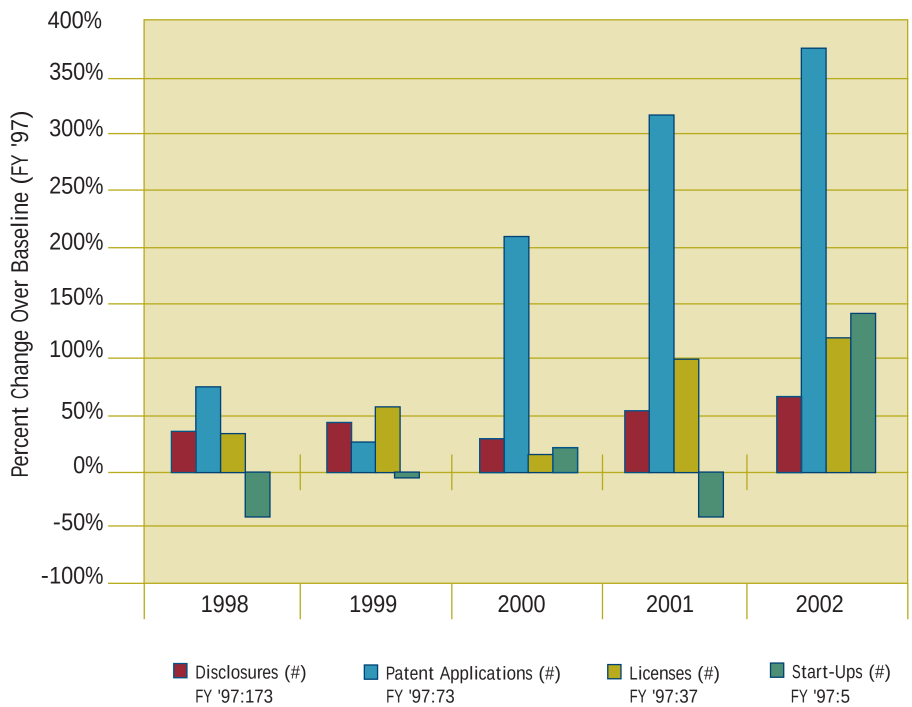
336 Lindback Awards for distinguished teaching

1418 Average Undergraduate SAT score for admitted students

Center for Technology Transfer

As a logical extension of Penn's research initiatives, the Center for Technology Transfer (CTT) is at the forefront of efforts to move discoveries from the laboratory to the marketplace. CTT manages the intellectual property assets emerging from the University's research enterprise, creating opportunities for the commercialization of academic discoveries for the public good. Penn now ranks among the nation's most successful institutions when it comes to turning faculty research into patents, licenses and start-up companies. Technology transfer activities launched 12 start-up companies in the fiscal year that ended June 30, many of which have established operations and hired employees in the Delaware Valley. The 12 companies spun off this year place Penn among the nation's strongest performers. CTT filed 349 patent applications on Penn technologies in 2002, a significant increase over previous years. More than half of the technologies that CTT patents become licensed. CTT managed 288 technology disclosures in 2002 along with the execution of 81 option and license agreements and 614 material transfer agreements, 20 percent more than in 2001.

CTT Activitiy Continues to Grow...



CTT is proud of its role in fostering the innovative application of Penn's cutting edge research and the resulting contributions to the University, the community and to the lives of people far beyond our region. Technologies commercialized by CTT in fiscal year 2002 include:

- A newly discovered protein, licensed to an established local company, that may lay the groundwork for treatments that prevent or cure osteoarthritis;
- A fuel cell that can run on gasoline and does not need hydrogen, developed by chemical engineers at Penn, is now the basis for a local start-up company;
- A new method of synthesizing ceramics used in the production of carbon nanotubes, licensed to a chemical-supply company;
- Various approaches to new cancer therapies, including a chemical compound that may prevent the growth and proliferation of cancer cells; an agent that is a potent promoter of immune cells; and a class of viral proteins that can selectively induce cell death in rapidly dividing cancer cells. The first two technologies were licensed to established firms in Seattle and San Francisco, respectively, and the third is the foundation for a local start-up company.

1779 Nations first University

6,128 Degrees granted by the University

3,745 International undergraduate and graduate students

7,600 Undergraduate / graduate students who reside on campus

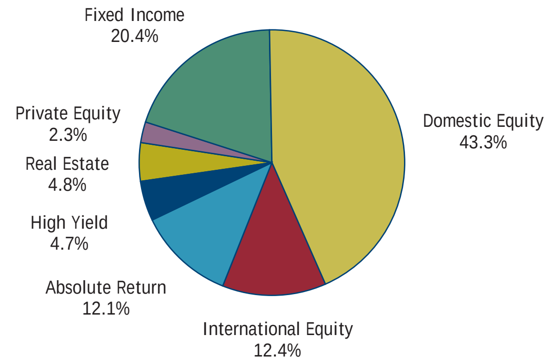
Endowment and Investments

Penn's endowment ended fiscal year 2002 with $3.4 billion in assets. The Associated Investments Fund ("A.I.F."), in which about 82% of the endowment is invested, generated an investment return of 0.1%, outperforming its composite benchmark by 6.8% in a year when worldwide equity markets had significant losses. For comparison, over the same period the Wilshire 5000 lost 16.6%, developed international markets lost 9.5% in US dollar terms, and a hypothetical portfolio invested 70% in the Wilshire 5000 stock index and 30% in the Lehman Government/Corporate bond index would have produced a loss of 9.4%. Compared to its peers, defined as other endowments with over $1 billion in assets, Penn's performance in fiscal year 2002 placed the University in the top quartile (source: Cambridge Associates). The median peer lost 3.8% during fiscal year 2002 and any peer endowment losing less than 2% was in the top quartile.

Manager selection throughout the portfolio was responsible for the bulk of the A.I.F.'s relative outperformance. All of Penn's active public equity managers outperformed their respective indexes by wide margins. And although only 12% of the A.I.F., Penn's international equity portfolio accounted for an even larger amount of the A.I.F.'s outperformance, as it exceeded its benchmark by 20%. This strong relative performance, coupled with a high allocation to public equity managers, accounted for almost all of the A.I.F.'s relative outperformance compared to its benchmark.

Investment grade bonds and real estate investments produced strong positive returns. Penn's hedge fund investment, which consists of various strategies that should not be highly correlated to public market returns, earned 5% for the year. Penn's nascent private equity portfolio suffered a loss due to fees and some write downs, but the overall effect on the A.I.F. was modest because of a relatively small allocation to these investments. One disappointment this year on a relative basis was high yield bonds, which lost money both in absolute and relative terms.

A.I.F. Assets Are Broadly Diversified...



Penn by the Numbers

18,784 Undergraduate applications

92,537 Number of donors to Penn's Annual Giving program

24,963 Number of employees

Development and Alumni Relations

Contributions recognized during fiscal year 2002 totaled $296.4 million. Contributions include cash, assets, services, or unconditional promises to give these items in the future. A major highlight was the fiscal year-end $100 million gift from the Annenberg Foundation that, in its first year, will support scholarships, faculty chairs and classroom refurbishing. Gift receipts of $365.5 million set a new record, as did Penn's annual giving programs, which produced $32.6 million in unrestricted support for a wide array of purposes and programs across the University. This is an extraordinary achievement given the weaker economy during the year.

Development and Alumni Relations activities included celebrations of the achievements of Penn's five-year ***Agenda for Excellence*** at events featuring President Rodin and Provost Barchi in seven major U.S. cities and in London. The University also recognized 125 Years of Women at Penn with a series of events and programs that brought 1,200 alumnae back to campus.

Increased revenue from Penn's on-line giving program during fiscal year 2002 reflected the growing importance of electronic communications with the University's constituents, and the number of Penn alumni who could be reached by e-mail grew to 87,000 – an increase of 30% over the previous year.

A comprehensive assessment of The Penn Fund, the University's annual giving program for undergraduate alumni, was also completed during the year. The assessment has already resulted in a number of changes designed to increase The Penn Fund's effectiveness in building participation and in generating vitally important unrestricted support for undergraduate education.

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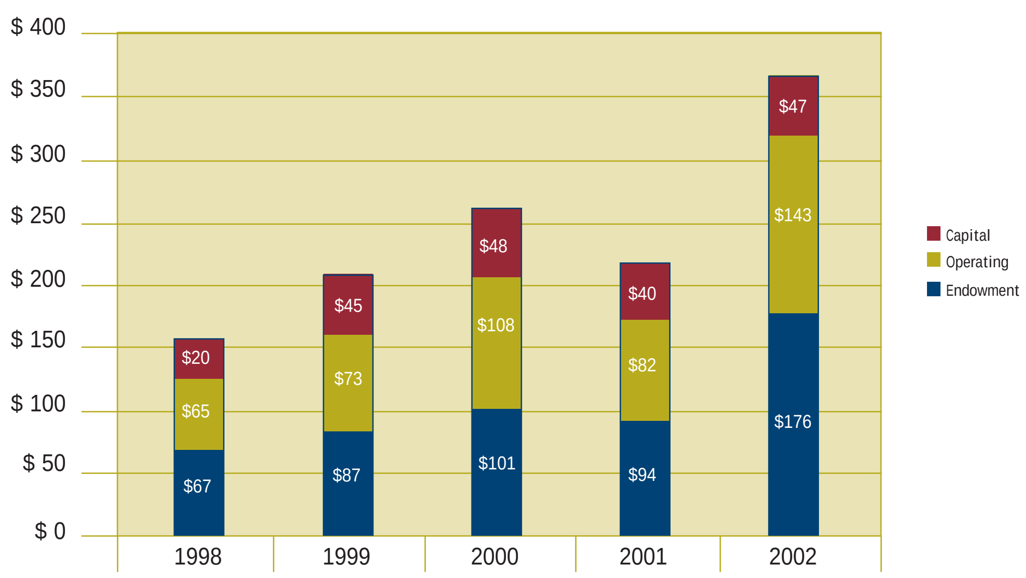
Gift Receipts Break the $300 Million Threshold...



5,000,000 Library books (approx.)

232,080 Living alumni of record

42,174,000 Commonwealth of Pennsylvania funding to the University

University of Pennsylvania Health System–Health Services Component

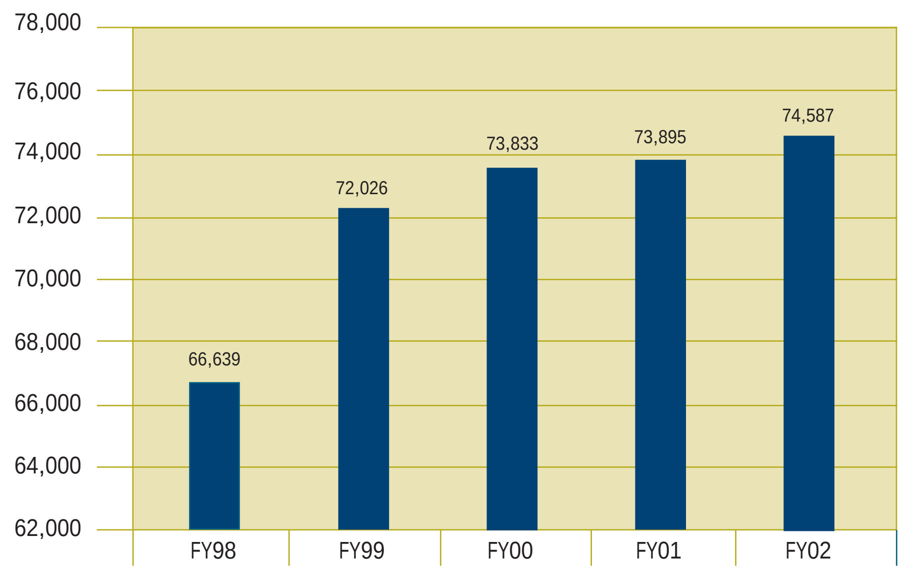
For the second consecutive fiscal year, the Health Services Component generated an operating surplus as it continued to make significant strides in its financial recovery. An operating margin – excess of revenues over expenses from operations – of $27.3 million (excluding investment income of $26.8 million) was generated. This represents a $2.2 million increase in operating margin over the previous fiscal year. The increase in total margin (excess of revenues over expenses before transfers and other non-operating) from fiscal year 2001 to fiscal year 2002 was $11.6 million.

In September 2001, the Health System welcomed Arthur H. Rubenstein, MBBCh, who assumed the position of Executive Vice President of the University of Pennsylvania for the Health System and Dean of the School of Medicine. During fiscal year 2002, the composition and responsibilities of Penn Medicine, the new umbrella governance structure for the Health System continued to unfold. The overall goal remains to streamline governance processes and enhance cooperation and creative interaction among the various entities of the Health System. At the same time, an inclusive, system-wide strategic planning initiative identified challenges and opportunities.

The Hospital of the University of Pennsylvania ("HUP") was once again named to the Honor Roll of American hospitals by *U.S. News & World Report*, one of only 17 hospitals in the country so named. HUP was ranked 13th overall and was commended for excellence in 14 medical specialties

Among the year's highlights was the establishment of the new Center for Excellence for Patient Safety Research and Practice, established through a $7 million grant from the Agency for Healthcare Research and Quality. The Health System is also playing a prominent role in two national studies. Penn researchers will track the health of 3,000 sufferers of Chronic Renal Insufficiency from seven sites across the country. Penn will receive about $17 million from the National Institute of Diabetes and Digestive and Kidney Disease to fund both the clinical and data coordinating centers on its campus. Researchers at the University of Pennsylvania Cancer Center (recently renamed the Abramson Cancer Center) are also taking part in a national study to determine if the two dietary supplements – selenium and vitamin E – can prevent prostate cancer. Penn is the coordinating site for 15 other Pennsylvania locations.

Adult Inpatient Admissions Continue Strong...



Penn by the Numbers

651,470,000 Sponsored program awards

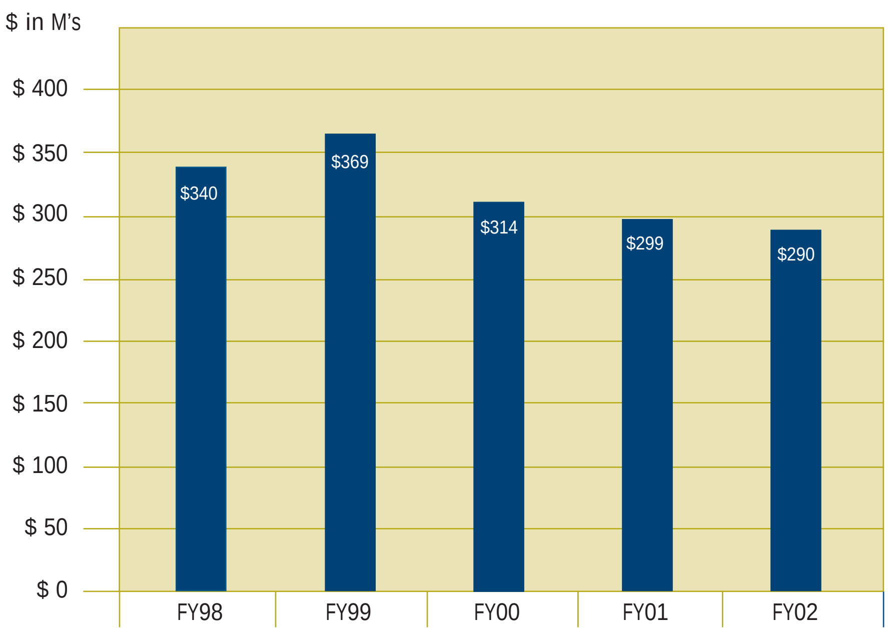
152,813,000 Student aid

Capital Investment

Fiscal year 2002 saw the completion of many major, multi-year capital projects. Academic buildings completed included the Wharton School's 324,000 square foot Huntsman Hall and the School of Dental Medicine's Schattner Center. There were also several major initiatives designed to improve student life that were completed in fiscal year 2002 including the Quadrangle Dormitory renovations, the construction of the Pottruck Health and Fitness Center and the Carriage House. In addition, the completion of the Bridge – Cinema De Lux and the Penn Alexander School (Pre K–8 school), developed in conjunction with the Philadelphia School District, continues to enhance the vibrancy and quality of Penn's campus and surroundings. In order to support current and future sponsored program growth, the University began implementation of PennERA, the University's Electronic Research Administration project that will meet current sponsor requirements and University operational and administrative needs well into the 21st century.

The Health Services Component continued its efforts to make targeted programmatic capital investments that had been deferred during its period of financial stress. Capital spending increased to $80 million in fiscal year 2002 reflecting its improved financial performance. Significant capital investments were made to support cardiac and cancer services at HUP, as well as a major outpatient radiology expansion at Penn Tower. Other notable investments were made to extend the implementation of the Epicare electronic medical records system, critical care renovations at Pennsylvania Hospital, emergency department renovations at Presbyterian Medical Center, and financial information systems supporting all areas of Health Services.

Purchase of Property, Plant and Equipment Remains Steady...



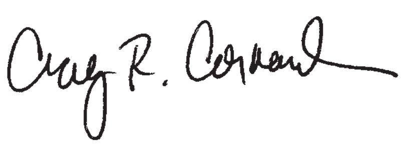
Summary and Future Outlook

Fiscal year 2002 saw the continuation of much positive momentum at Penn. This was a year in which we continued to "build on excellence," consistent with the name of our new strategic plan. The increased desirability of Penn as a first choice among applicants and the selectivity of our students have been truly impressive. Our undergraduate program ranking was upgraded to 4th nationally, from its prior 5th place ranking, by *U.S. News & World Report*. Penn's distinguished faculty continues to be recognized in terms of awards, research and publications. The campus is vibrant with exciting new academic, student life and community structures. The continued turnaround of our Health Services Component, the significant increase in research awards, the growth in gifts in a difficult economic environment and the positive investment performance of our endowment despite dismal market conditions are also among the year's noteworthy highlights.

We were able to weather the year's difficult economic climate because of the quality of our diverse revenue sources, the loyalty of our alumni and sponsors, and our strong management initiatives. A prolonged economic decline may prove somewhat more difficult, particularly for revenue sources not impacted by student demand, which has traditionally been considered recession-resistant.

The past year was a sobering one at Penn as it was for the rest of our nation following the 9/11 terrorist activities. In these tragedies, we lost 16 alumni of the University. Nonetheless, we have found that these events have evoked an interest among our constituents in what has made a difference in their lives and the importance of their Penn education is a recurring theme.

In closing, I'd like to acknowledge the contributions of John Fry and Virginia Clark, who left their respective positions as Executive Vice President and Vice President for Development and Alumni Relations at the University just after the end of fiscal year 2002. Their vision and remarkable work will benefit the Penn community for years to come. I would also like to express thanks to the many supporters of the Penn community who helped make this year a success for the University. It is an exciting time to be associated with the University as we work to fulfill Penn's strategic objectives with alumni, students, faculty, staff and other sponsors.



Craig R. Carnaroli
Vice President for Finance and Treasurer

A Five-Year Review of Investments

(Thousands of Dollars)

	2002	2001	2000	1999	1998
Investments:					
Fair Value					
Stocks*	$1,692,216	$1,902,998	$1,695,205	$2,181,568	$1,758,030
Bonds*	1,217,517	915,088	1,321,508	962,844	1,048,050
Short-term	377,052	343,810	348,561	449,797	538,662
Other	582,476	470,393	354,332	181,663	215,025
Total Investments*	$3,869,261	$3,632,289	$3,719,606	$3,775,872	$3,559,767
Endowment:					
Fair Value	$3,393,297	$3,381,848	$3,200,712	$3,281,306	$3,059,401
Associated Investments Fund:					
Fair Value	$2,772,040	$2,800,390	$2,556,597	$2,661,621	$2,138,012

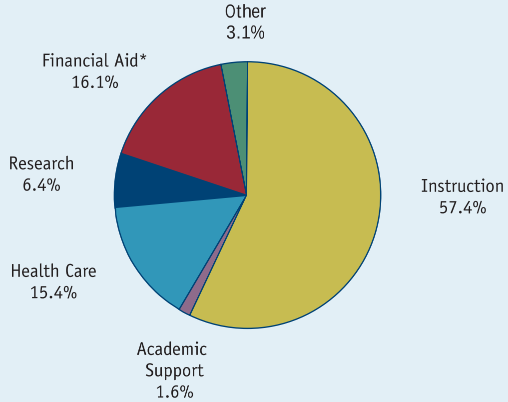
* Excludes securities pledged under a securities lending program.

Endowment

Total Endowment

The role of Penn's endowment is to support its schools and centers by generating a growing, real (inflation-adjusted) flow of funds for the operating budget. On June 30, 2002, the endowment had a market value of $3.4 billion and funded 3.8% of the University's consolidated operating budget during the fiscal year. Penn's total endowment is comprised of individual endowments from all of Penn's schools and centers, which serve a variety of purposes as shown in the chart below.

Endowment by Purpose

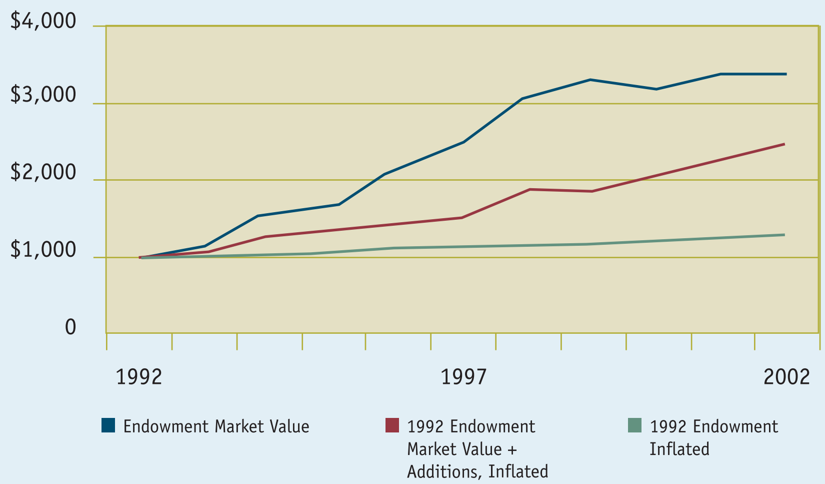


* Includes undergraduate direct grants and graduate direct grants and stipends

Over the fiscal year, the market value of the endowment increased by $11.4 million. Increases to endowment included net gifts and transfers of $163.8 million. This was partially offset by realized and unrealized losses from investments of $108.8 million and reductions to the endowment from a liquidation of $43.6 million in principal required to meet the endowment spending rule payout.

To illustrate the endowment's real growth over time, the blue line in the following chart shows the growth in actual endowment value including the impact of investment performance, gifts and spending distributions to the University. The red line shows the growth in endowment including gifts and spending rule liquidation, but without the impact of investment performance. Finally, the green line shows the value of the endowment had it grown solely at the rate of inflation. This chart illustrates that the endowment's investment performance has significantly added value over and above new gifts and inflation over this time period.

Endowment Growth vs. Inflation



Associated Investments Fund

Penn's asset allocation strategy, one of the major determinants of its long-run investment performance, is implemented through a pooled investment fund called the Associated Investments Fund ("A.I.F."). The vast majority of the University's endowment is invested in the A.I.F., which had a market value of $2.8 billion as of June 30, 2002. The A.I.F. is managed externally by third parties to maximize total returns from both current income and capital appreciation while assuming a tolerable level of risk. Over the years the University has strategically changed the A.I.F.'s asset allocation by increasing its diversification and reducing its dependence on long-only public domestic equities and bonds.

For fiscal 2002 the endowment generated an investment return of 0.1%, out-performing its composite benchmark by 6.8%. For comparison, a hypothetical portfolio invested 70% in the Wilshire 5000 stock index and 30% in the Lehman Government/Corporate bond index would have produced a loss of 9.4% over the same period. Long-term performance provides a meaningful context in which to evaluate investment performance, as illustrated below:

Total Return Performance Comparison

Periods Ended June 30, 2002
Annualized Returns (%)

Category	10 Years	5 Years	3 Years	1 Year
Associated Investments Fund (AIF)	10.5	5.5	1.4	0.1
Composite Index *	9.4	4.1	-3.3	-6.7
Wilshire 5000	10.9	2.8	-10.5	-16.6
Lehman Bros. Gov't./Credit Index	7.4	7.5	7.9	8.2

* The Composite Index is a benchmark that consists of the Wilshire 5000, EAFE, NCREIF, Lehman Gov't./Credit, and Salomon High Yield indices in a weighting consistent with the A.I.F.'s policy asset allocation.

Associated Investments Fund

A.I.F. Spending

The University's endowment spending policy is designed to smooth the short-term impact of volatile capital markets that affect the endowment's market value. Its goal is to make future endowment distributions more predictable for purposes of managing and planning the University's operating budget. For fiscal year 2002 the spending policy is 4.7% of the three-year average market value of the A.I.F., lagged by one year. The market value of the A.I.F. is calculated net of all external management fees and net of the internal costs of managing the endowment.

During fiscal year 2002, the total amount distributed under the spending policy was $118.9 million of which $21 million was allocated for the general overhead (e.g., heat, light, maintenance) of the schools and centers benefiting from the endowment. Over the past decade, unitized spending has grown by 5.9% annually, well in excess of the rate of inflation.

Management Responsibility for Financial Statements

The management of the University of Pennsylvania is responsible for the preparation, integrity and fair presentation of the financial statements. The financial statements, presented on pages 25 to 42, have been prepared in accordance with generally accepted accounting principles and, as such, include amounts based on judgments and estimates by management. The University also prepared the other information included in this annual report and is responsible for its accuracy and consistency with the financial statements.

The financial statements have been audited by the independent accounting firm PricewaterhouseCoopers LLP, which was given unrestricted access to all financial records and related data, including minutes of all meetings of trustees. The University believes that all representations made to the independent auditors during their audit were valid and appropriate. PricewaterhouseCoopers' audit opinion is presented on page 24.

The University maintains a system of internal controls over financial reporting, which is designed to provide a reasonable assurance to the University's management and board of trustees regarding the preparation of reliable published financial statements. Such controls are maintained by the establishment and communication of accounting and financial policies and procedures, by the selection and training of qualified personnel, and by an internal audit program designed to identify internal control weakness in order to permit management to take appropriate corrective action on a timely basis. There are, however, inherent limitations in the effectiveness of any system of internal control, including the possibility of human error and the circumvention of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation. Furthermore, the effectiveness of an internal control system can change with circumstances.

The Trustees of the University of Pennsylvania, through its Committee on Audit and Compliance comprised of trustees not employed by the University, is responsible for engaging the independent accountants and meeting with management, internal auditors, and the independent accountants to ensure that each is carrying out their responsibilities. Both internal auditors and the independent accountants have full and free access to the Committee on Audit and Compliance

Judith Rodin
President

Craig R. Carnaroli
Vice President for Finance
and Treasurer

Kenneth B. Campbell
Comptroller

Report of Independent Accountants

To the Trustees of the
University of Pennsylvania

In our opinion, the accompanying statement of financial position and the related statements of activities and of cash flows present fairly, in all material respects, the financial position of the University of Pennsylvania on June 30, 2002, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of University management; our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the University of Pennsylvania's 2001 financial statements; and in our report dated October 19, 2001, we expressed an unqualified opinion on those financial statements. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

September 20, 2002
Philadelphia, Pennsylvania

Statement of Financial Position

(thousands of dollars)

	June 30, 2002	June 30, 2001
Assets		
Cash and cash equivalents	$187,843	$309,186
Accounts receivable, net of allowances of $14,141 and $13,904	115,754	113,932
Patient receivables, net of allowances of $115,941 and $67,639	347,660	345,689
Contributions receivable, net	216,621	229,228
Loans receivable, net of allowances of $4,020 and $3,319	102,582	104,083
Other assets	187,033	164,538
Investments, at fair value	4,435,406	3,883,036
Plant, net of depreciation	2,620,145	2,505,891
Total assets	$8,213,044	$7,655,583
Liabilities		
Accounts payable	$105,327	$105,427
Accrued expenses and other liabilities	549,610	496,622
Collateral due broker	566,145	250,747
Deferred income	49,919	46,392
Deposits, advances, and agency funds	90,791	79,225
Federal student loan advances	79,009	77,300
Accrued retirement benefits	181,095	179,339
Debt obligations	1,434,877	1,389,831
Total liabilities	3,056,773	2,624,883
Net assets		
Unrestricted	2,574,503	2,530,680
Temporarily restricted	1,174,929	1,250,270
Permanently restricted	1,406,839	1,249,750
	5,156,271	5,030,700
Total liabilities and net assets	$8,213,044	$7,655,583

See accompanying notes to financial statements

Statement of Activities

for the year ended June 30, 2002
(with summarized financial information for the year ended June 30, 2001)
(thousands of dollars)

	Unrestricted	Restricted Temporarily	Restricted Permanently	2002	2001
Revenue and other support:					
Tuition and fees, net	$453,824			$453,824	$433,131
Commonwealth appropriations	42,174			42,174	40,878
Sponsored programs	579,727			579,727	503,223
Contributions	34,804	$57,845		92,649	82,777
Investment income	97,982	83,531		181,513	196,693
Hospitals and physician practices	1,754,159			1,754,159	1,676,861
Sales and services of auxiliary enterprises	67,076			67,076	71,535
Other income	131,403			131,403	124,801
Independent operations	48,845			48,845	52,950
Net assets released from restrictions	110,274	(110,274)			
	3,320,268	31,102		3,351,370	3,182,849
Expenses:					
Program:					
Instruction	625,005			625,005	571,645
Research	486,474			486,474	428,044
Hospitals and physician practices	1,714,078			1,714,078	1,642,401
Auxiliary enterprises	87,763			87,763	85,376
Other educational activities	99,019			99,019	95,097
Student services	37,562			37,562	35,302
Support:					
Academic support	51,247			51,247	52,735
Management and general	154,471			154,471	141,414
Independent operations	55,311			55,311	55,314
	3,310,930			3,310,930	3,107,328
Increase in net assets before nonoperating revenue, net gains, reclassifications and other	9,338	31,102		40,440	75,521
Nonoperating revenue, net gains, reclassifications and other:					
(Loss) gain on investment, net	(10,325)	(85,236)	$10,094	(85,467)	32,217
Investment income, net of amounts classified as operating revenue	(10,834)	(23,431)	1,119	(33,146)	(11,259)
Contributions	5,416	52,452	145,876	203,744	176,468
Other					(4,434)
Net assets released from restrictions	50,228	(50,228)			
Increase in net assets	43,823	(75,341)	157,089	125,571	268,513
Net assets, beginning of period	2,530,680	1,250,270	1,249,750	5,030,700	4,762,187
Net assets, end of period	$2,574,503	$1,174,929	$1,406,839	$5,156,271	$5,030,700

See accompanying notes to financial statements

Statement of Cash Flows

(thousands of dollars)

	2002	2001
Cash flows from operating activities:		
Increase in net assets	$125,571	$268,513
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	184,406	191,141
Provision for bad debts	125,634	93,600
Loss (gain) on investments, net	85,467	(32,217)
(Gain) loss on disposal of plant, property and equipment	(5,039)	5,501
Nonoperating revenue designated for the acquisition of long-lived assets and long-term investment	(170,598)	(165,209)
Changes in operating assets and liabilities:		
Patient, accounts and loans receivable	(98,479)	(60,463)
Contributions receivable	(4,910)	(12,063)
Other assets	(7,712)	(25,867)
Accounts payable, accrued expenses and accrued retirement benefits	29,223	(18,845)
Deposits, advances and agency funds	11,566	4,497
Deferred income	3,527	(1,653)
Net cash provided by operating activities	278,656	246,935
Cash flows from investing activities:		
Student loans repaid	15,999	7,425
Student loans issued	(18,801)	(13,766)
Purchase of investments	(6,902,328)	(6,779,927)
Proceeds from sale of investments	6,544,230	6,897,770
Purchase of plant, property and equipment	(290,475)	(298,725)
Net cash used by investing activities	(651,375)	(187,223)
Cash flows from financing activities:		
Proceeds from contributions received designated for the acquisition of long-lived assets and long-term investment	205,760	124,583
Federal student loan advances	1,709	9,732
Repayment of long-term debt	(105,261)	(28,980)
Issuance of long-term debt	149,168	
Net cash provided by financing activities	251,376	105,335
Net (decrease) increase in cash and cash equivalents	(121,343)	165,047
Cash and cash equivalents, beginning of period	309,186	144,139
Cash and cash equivalents, end of period	$187,843	$309,186
Supplemental disclosure of cash flow information:		
Cash paid for interest	$58,633	$71,464
Non-cash activity		
Moveable inventory writeoff	—	$4,434
Due to First Hospital Foundation	$1,058	$(1,743)

See accompanying notes to financial statements

Notes to Financial Statements

1. Significant Accounting Policies

Organization

The University of Pennsylvania (the University), located in Philadelphia, Pennsylvania, is an independent, nonsectarian, not-for-profit institution of higher learning founded in 1740. The University Academic Component (Academic Component) provides educational services, primarily for students at the undergraduate, graduate, professional and postdoctoral levels and performs research, training and other services under grants, contracts, and similar agreements with sponsoring organizations, primarily departments and agencies of the United States Government. The University also operates an integrated health care delivery system, the University of Pennsylvania Health System-Health Services Component (Health Services Component).

Basis of Presentation

The financial statements have been prepared on the accrual basis and include the accounts of the University of Pennsylvania and its subsidiaries. All material transactions between the University and its subsidiaries have been eliminated.

The net assets of the University are classified and reported as follows:

Unrestricted - Net assets that are not subject to donor-imposed restrictions.

Temporarily restricted - Net assets that are subject to legal or donor-imposed restrictions that will be met by actions of the University and/or the passage of time. These net assets include gifts donated for specific purposes and capital appreciation on permanent endowment, which is restricted by Pennsylvania law on the amounts that may be expended in a given year.

Permanently restricted - Net assets that are subject to donor-imposed restrictions that require the original contribution be maintained in perpetuity by the University, but permits the use of the investment earnings for general or specific purposes.

Expenses are reported as a decrease in unrestricted net assets. Gains and losses on investments are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions recognized on net assets are reported as net assets released from restrictions from temporarily restricted net assets to unrestricted net assets.

The financial statements include certain prior-year summarized comparative information in total, but not by net asset category. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the University's financial statements for the year ended June 30, 2001 from which the summarized information was derived. Certain reclassifications have been made to the summarized financial information for comparative purposes.

Cash and Cash Equivalents

Cash equivalents include short-term U.S. Treasury securities and other short-term, highly liquid investments and are carried at cost which approximates fair value. Short-term investments with maturities of three months or less when purchased are classified as cash equivalents, except that any such investments held in trusts or by external investment managers are classified as investments.

Investments

Investments in equity and debt securities with readily determinable fair values are reported at fair value. Changes in fair value of investments are reported in the University's Statement of Activities. Fixed

Notes to Financial Statements

income investments with a maturity of less than one year are included in short-term investments. Derivative financial instruments held for investment purposes are carried at fair value with the resulting gains and losses included in investment earnings for the period. The University's principal derivative financial instruments are forward mortgage contracts. Fair values for certain private equity and real estate investments held through limited partnerships or commingled funds are estimated by the respective external investment managers if market values are not readily ascertainable. These valuations necessarily involve assumptions and methods that are reviewed by the University. Restricted securities are valued at the last sale price at the valuation date with an illiquidity discount of 20 percent.

The majority of the endowment funds of the University have been pooled in the University's Associated Investments Fund (A.I.F.), which is invested primarily in three investment pools, an Equity Fund, a Fixed Income Fund and a High Yield Fund. The University has adopted an endowment spending policy governing the expenditure of the total return of funds invested in the A.I.F. The spending policy is designed to manage annual spending levels and is independent of the cash yield and appreciation of investments for the year. The A.I.F. returns available for expenditure in 2002 were $118,907,000, which exceeded available investment income by $43,568,000. The A.I.F. returns available for expenditure in 2001 were $108,670,000, which exceeded available investment income by $12,913,000.

Included in Investments is $6,800,000 and $7,911,000 of cash that is held in escrow at June 30, 2002 and 2001, respectively.

Loans Receivable

Student loans receivable are reported at their net realizable value. Such loans include donor-restricted and federally-sponsored student loans with mandated interest rates and repayment terms. Determination of the fair value of student loans receivable is not practicable.

Plant

Plant is stated at cost, or fair value at the date of donation, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the assets. Contents, rare books and other collectibles aggregating $18,533,000 at June 30, 2002 and $14,120,000 at June 30, 2001 are not subject to depreciation. Upon disposal of assets, the cost and related accumulated depreciation are removed from the accounts and the resulting gain or loss is included in operations.

Intangible Assets

Intangible assets are included in other assets in the accompanying Statement of Financial Position. Intangible assets consist of acquisition costs, the excess of cost over net assets acquired, and non-competition agreements related to the acquisition of physician practices, which are amortized on a straight-line basis over five years or the lives of the respective non-competition agreements. Goodwill associated with the statutory merger of the Presbyterian Medical Center of Philadelphia into the Health Services Component is being amortized over thirty years on a straight-line basis.

Split-Interest Agreements

The University's split-interest agreements with donors consist primarily of charitable gift annuities, pooled income funds and irrevocable charitable remainder trusts for which the University serves as trustee. Assets are invested and payments are made to donors and/or other beneficiaries in accordance with the respective agreements.

Contribution revenue for charitable gift annuities and charitable remainder trusts is recognized at the date the agreement is established, net of the liability recorded for the present value of the estimated future payments. Contribution revenue for pooled income funds is recognized upon establishment of the agreement, at the fair value of the estimated future receipts discounted

Notes to Financial Statements

for the estimated time period to complete the agreement.

The present value of payments to beneficiaries of charitable gift annuities and charitable remainder trusts and the estimated future receipts from pooled income funds are calculated using discount rates which represent the risk-free rates in existence at the date of the gift. Gains or losses resulting from changes in actuarial assumptions and accretions of the discount are recorded as increases or decreases in the respective net asset category in the Statement of Activities.

The liability to donors and beneficiaries under terms of the agreements included in Accrued expenses and other liabilities is as follows (in thousands):

	2002	2001
Charitable gift annuities	$21,186	$18,499
Charitable remainder trusts	17,624	19,465
Pooled income funds	1,181	3,201
Total split-interest agreements	$39,991	$41,165

Tuition and Fees

The University maintains a policy of offering qualified applicants admission to the University without regard to financial circumstance. This policy provides financial aid to those admitted in the form of direct grants, loans, and employment during the academic year. Tuition and fees have been reduced by certain scholarships and discounts in the amount of $113,060,000 in 2002 and $101,546,000 in 2001.

Sponsored Programs

The University receives grant and contract revenue from governmental and private sources. In 2002 and 2001, grant and contract revenue earned from governmental sources totaled $483,941,000 and $416,853,000, respectively. The University recognizes revenue associated with the direct costs of sponsored programs as the related costs are incurred. Indirect costs recovered on federally-sponsored programs are based on predetermined reimbursement rates negotiated with the University's cognizant federal agency, the Department of Health and Human Services. Indirect costs recovered on all other grants and contracts are based on rates negotiated with the respective sponsor. Funds received for sponsored research activity are subject to audit. Based upon information currently available, management believes that any liability resulting from such audits will not materially affect the financial position or operations of the University.

Contributions

Contributions are reported as increases in the appropriate net asset category based on donor restrictions. Contributions, including unconditional promises to give, are recognized as revenue in the period received at their fair values. Unconditional pledges are recognized at their estimated net present value, net of an allowance for uncollectible amounts, and are classified in the appropriate net asset category. Unconditional promises to give and contributions of cash and other

Notes to Financial Statements

assets designated for the acquisition of long-lived assets and long-term investment are reported with nonoperating revenue, net gains, reclassifications and other.

Health Services Component

Revenue of the Health Services Component is derived primarily from patient services and is accounted for at established rates on the accrual basis in the period the service is provided. Net patient service revenue is net of charity care and community service. Certain revenue received from third-party payors is subject to audit and retroactive adjustment. Additionally, the Health Services Component has entered into certain contracts under which it is responsible for providing medical care to covered members at predetermined rates. Any changes in estimates under these contracts are recorded in operations currently.

Allocation of Certain Expenses

The Statement of Activities presents expenses by functional classification. Operation and maintenance of plant and depreciation are allocated to functional classifications based on square footage. Interest expense is allocated to the functional classifications of the activity that directly benefited from the proceeds of the debt.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

2. University of Pennsylvania Health System - Health Services Component

The Trustees of the University formed the University of Pennsylvania Health System (the Health System) in June 1993 to operate as an integrated system that delivers education, research, and patient care. The Health System includes the Health Services Component and the School of Medicine of the University. The Health Services Component is comprised of the Hospital of the University of Pennsylvania, the Clinical Practices of the University of Pennsylvania, the Presbyterian Medical Center of the University of Pennsylvania Health System, Clinical Care Associates, Wissahickon Hospice of the University of Pennsylvania Health System, Phoenixville Hospital and Pennsylvania Hospital.

In 2002 the activities of the Health Services Component's risk retention program, supported and administered by Franklin Casualty Insurance Company, a wholly owned Risk Retention Group, and Quaker Insurance Company Ltd., a wholly owned offshore captive insurance company, (collectively referred to as RRG/Captive), are included in the combined financial statements.

During 2002, the Trustees formed Penn Medicine, the new governance structure under which the Health Services Component and the School of Medicine operate. The new governing body operates, oversees, and coordinates the academic, research and clinical missions of Penn Medicine. Penn Medicine replaces the prior multiple governing boards of the Health Services Component and the School of Medicine, all of which were dissolved, with this single governing board.

Throughout the year, certain transactions are conducted between the Health Services Component and the University. The effect of these transactions (primarily inter-entity billings for allocations of common costs and certain purchased services) is included in the financial information of the Health Services Component. At June 30, 2002 and 2001, the Health Services Component net liability to the University was $24,938,000 and $49,807,000, respectively, for various inter-entity billings. The University and the Health Services Component reached a formal agreement for the repayment of the

Notes to Financial Statements

inter-entity advance during 2001. Under the terms of the agreement, the Health Services Component will make payments to fully satisfy its obligation by June 30, 2003.

The Health Services Component transferred to the School of Medicine from its operations $33,050,000 and $29,794,000 in 2002 and 2001, respectively, to further research and educational activities. These activities are integral to the overall mission of the Health System and the effect of the transfers is reflected in the Health Services Component net assets.

Final adjustments to revenue, resulting from settlements with third-party payors, are recorded in the year in which they are settled. Third party settlements decreased net patient revenue by $244,000 in 2002 and increased net patient revenue by $1,922,000 in 2001.

During 2002, the Health Services Component and Independence Blue Cross (IBC) reached agreement on terms of a five-year agreement. As part of this contract negotiation, there was a one-year deferral of repayment terms set to begin in December 2002 for certain IBC advances. The advances due IBC are reflected as liabilities, at their discounted value.

Under the new agreements payments made to the Hospital of the University of Pennsylvania, Presbyterian Medical Center, Pennsylvania Hospital and Phoenixville Hospital for inpatient services provided to IBC traditional and managed care subscribers are effected on a per case rate basis for neurosurgery, cardiac and orthopaedic surgery as well as an expanded list of cancer and other high-cost, short-length of stay procedures. All other services are paid based on a per diem rate structure. Payment for outpatient services rendered to IBC traditional and managed care subscribers will convert from principally based upon a percentage of billed charges to principally fee-schedule based by June 2003. The inpatient and outpatient rates also provide for annual inflationary increases above the historical and projected market basket rate of inflation.

Notes to Financial Statements

Summarized financial information for the Health Services Component as of June 30, 2002 and 2001, prior to eliminations for transactions between the Health Services Component and other entities of the University, is as follows (in thousands):

	2002	2001
Net patient service and premium revenue	$1,668,101	$1,584,243
Other revenue	114,882	119,674
Total expenses	(1,728,873)	(1,646,083)
Excess of revenues over expenses from operations	54,110	57,834
Non-operating, net	(20,493)	25,810
Increase in net assets after inter-entity transfers	$33,617	$83,644
Total current assets	$497,653	$480,080
Investments and assets whose use is limited (including board designated funds of $291,647 and $276,148 and trustee held funds of $28,247 and $20,707 for 2002 and 2001, respectively)	671,665	646,975
Property, plant and equipment, net	607,789	610,096
Other assets	85,141	81,595
Total assets	$1,862,248	$1,818,746
Total current liabilities	$313,824	$308,426
Long-term debt, net of current portion	799,048	783,387
Other liabilities	263,641	274,815
Total liabilities	1,376,513	1,366,628
Net assets		
Unrestricted	157,200	107,260
Temporarily restricted	233,503	245,099
Permanently restricted	95,032	99,759
Total net assets	485,735	452,118
Total liabilities and net assets	$1,862,248	$1,818,746

3. Investments

A summary of investments, stated at fair value, at June 30, 2002 and 2001 is as follows (in thousands):

	2002	2001
Investment sales receivable	$93,456	$149,233
Short-term	377,052	343,810
Stocks	1,943,101	1,769,372
Bonds	1,439,321	1,150,268
Real estate	164,232	120,128
Other	418,244	350,225
End of year	$4,435,406	$3,883,036
Beginning of year	$3,883,036	$3,719,606

Notes to Financial Statements

Included in investments are assets held in trust for the University with an aggregate fair value of $256,082,000 at June 30, 2002 and $162,636,000 at June 30, 2001.

In connection with a University-sponsored loan program, the University is required to invest in certificates of deposit of the lending institution. At June 30, 2002 and 2001, short-term investments held under this arrangement aggregated $7,030,000 and $9,525,000, respectively.

At June 30, 2002 and 2001, investments with a fair value of $29,447,000 and $24,130,000, respectively were held by trustees under indenture and escrow agreements.

At June 30, 2002 and 2001, investments with a fair value of $552,960,000 and $243,807,000, respectively, were loaned on an overnight basis to various brokers. The University receives lending fees and continues to earn interest and dividends on the loaned securities. These securities are returnable on demand and are collateralized by cash deposits. The borrower has provided $566,145,000 and $250,747,000 of cash collateral for the loaned securities at June 30, 2002 and June 30, 2001. The University is indemnified against borrower default by the financial institution that is acting as its lending agent.

At June 30, 2002 and 2001, short-term investment securities with a fair value of $158,633,000 and $210,603,000, respectively, have been earmarked for the purchase of other long-term investments.

A summary of the University's total investment return for the years ended June 30, 2002 and 2001 as reported in the Statement of Activities is presented below (in thousands):

	2002	2001
A.I.F. investment income	$95,650	$119,177
A.I.F. realized and unrealized (losses) and gains	(92,767)	39,954
Return on the A.I.F.	2,883	159,131
Other investment income, gains and losses	60,017	58,520
Total return on investments	$62,900	$217,651

4. Contributions Receivable

A summary of contributions receivable is as follows at June 30, 2002 and 2001 (in thousands):

	2002	2001
Unconditional promises expected to be collected in:		
Less than one year	$48,156	$43,783
One year to five years	219,353	242,313
Over five years	12,661	13,080
	280,170	299,176
Less: Discount and allowance for doubtful amounts	(63,549)	(69,948)
Contributions receivable, net	$216,621	$229,228

Because of uncertainties with regard to their realizability and valuation, bequest intentions and other conditional promises are not estimated by management and are recognized if and when the specified conditions are met.

Notes to Financial Statements

5. Plant

The components of plant at June 30, 2002 and 2001 are as follows (in thousands):

	2002	2001
Land	$82,621	$79,098
Buildings (a)	2,761,318	2,599,206
Contents	1,264,652	1,207,774
Construction-in-progress	358,530	303,615
	4,467,121	4,189,693
Less accumulated depreciation	(1,846,976)	(1,683,802)
Plant	$2,620,145	$2,505,891

(a) Includes $82,337,000 and $79,725,000 at June 30, 2002 and 2001, respectively, of completed facilities which serve as collateral for debt obligations.

The University recorded $179,819,000 and $182,911,000 of depreciation expense for the years ended June 30, 2002 and 2001, respectively.

6. Debt Obligations

Debt obligations at June 30, 2002 and 2001 are as follows (in thousands):

	Maturity	Interest Rate at June 30, 2002	June 30, 2002	June 30, 2001
Academic Component:				
Fixed Rate Debt Obligations:				
Pennsylvania Higher Education Facility Authority (PHEFA)				
Series of 1968	--	--	--	$19,950
Series of 1968 Ware College House	2003	6.8%	$11	117
Series A of 1995 Revenue Bonds	2016	5.3% - 7.0%	92,285	96,340
Series B of 1995 Revenue Bonds	2016	5.3% - 7.0%	41,525	43,350
Series of 1998 Revenue Bonds	2039	4.5% - 5.5%	194,630	196,500
Unamortized Discount			(2,020)	(2,101)
Series A of 2002 Revenue Bonds	2009	3.0% - 5.0%	16,825	--
Unamortized Premium			759	--
Department of Education Bonds	2007	3.0%	313	372
Other Loans	various	5.0% - 9.8%	11,578	8,804
Mortgage Notes	various	8.0%	8,089	8,239
Total Fixed Rate Debt Obligations			363,995	371,571
Variable Rate Debt Obligations:				
PHEFA				
Series of 1985 Revenue Bonds	2017	1.73%	$10,610	$10,610
Series of 1990 Revenue Bonds	2021	1.73%	6,500	6,500
Series B of 2002 Revenue Bonds	2033	1.34%	50,300	--

Notes to Financial Statements

	Maturity	Interest Rate at June 30, 2002	June 30, 2002	June 30, 2001
Quakertown General Authority				
Pool Financing	2006	2.25%	$71,745	$71,745
Washington County Authority				
Lease Revenue Bonds	2006	1.30%	57,460	59,701
Pennsylvania Economic				
Development Financing Authority	2005	1.90%	20,240	--
Other Loans	various	2.1% - 2.4%	16,724	44,317
Total Variable Rate Debt Obligations			233,579	192,873
Total Academic Component Debt Obligations			597,574	564,444
Health Services Component:				
Fixed Rate Debt Obligations:				
PHEFA				
Series A of 1994 Revenue Bonds	2010	5.6% - 7.0%	35,000	35,000
Unamortized Premium			538	610
Series A and B 1996 Revenue Bonds	2022	4.9% - 6.0%	390,235	403,676
Unamortized Discount			(2,400)	(2,500)
Series A of 1998 Revenue Bonds	2015	4.4% - 5.4%	38,750	38,750
Unamortized Premium			661	712
Series of 2002 Revenue Bonds	2024	7.50%	26,065	--
Notes Payable	2006	7.0% - 8.5%	14,725	25,821
Capital Leases	various	4.6% - 5.9%	31,331	1,955
Mortgage Notes	--	--	--	217
Total Fixed Rate Debt Obligations			534,905	504,241
Variable Rate Debt Obligations:				
PHEFA				
Series B of 1994 Revenue Bonds	2024	1.15%	90,000	90,000
Series C of 1996 Revenue Bonds	2026	1.15%	80,000	80,000
Series B of 1998 Revenue Bonds	2026	1.15%	121,600	121,600
Pennsylvania Economic Development				
Financing Authority Series C of				
1994 Revenue Bonds	2015	2.0%	9,583	10,066
Mortgage Notes	2007	5.7%	1,215	1,480
Term Loan	--	--	--	18,000
Total Variable Rate Debt Obligations			302,398	321,146
Total Health Services Component				
Debt Obligations			837,303	825,387
Total Academic and Health Services				
Component Debt Obligations			$1,434,877	$1,389,831

Notes to Financial Statements

The fair value of the University's debt obligations was $1,321,819,000 and $1,406,787,000 at June 30, 2002 and 2001, respectively. The fair value represents the quoted market value for PHEFA Revenue Bonds and carrying amounts for all other debt, which approximates fair value.

Maturities of debt obligations for each of the next five years are as follows (in thousands):

Fiscal Year	Amount
2003	$ 40,427
2004	44,819
2005	143,415
2006	95,602
2007	47,775

Academic Component

On August 1, 2001, the Pennsylvania Economic Development Financing Authority issued Revenue Bonds, Series 2001A, with an aggregate principal amount of $20,240,000. The proceeds of the bonds were then loaned pursuant to a Loan Agreement dated August 1, 2001, to University City Associates, Inc. (UCA), a wholly owned subsidiary of the University, to be used for the construction of a new pre K-8 University-assisted public school in the West Philadelphia area. The Bonds mature on January 1, 2005, subject to early redemption by the Authority or bondholders at a purchase price equal to 100% of the principal amount thereof plus accrued interest. The Bonds bear a floating rate of interest, which is adjusted by the Authority at certain intervals. Under the Loan Agreement, UCA will make payments sufficient to fund the debt service of the Bonds, which consists of interest due each year until maturity and principal due January 2005. This debt was fully retired on August 1, 2002.

On February 28, 2002, the Pennsylvania Higher Educational Facilities Authority (the Authority) issued Revenue Bonds, Series 2002A, with an aggregate principal amount of $16,825,000. The proceeds were used to refund the Series 1968 bonds, which were redeemed on April 4, 2002. The Series 2002A bonds mature in varying annual amounts ranging from $2,235,000 in 2003 to $2,435,000 in 2008. The bonds are subject to extraordinary special redemption by the Authority at a price equal to 100% of the principal amount plus accrued interest to the redemption date.

On February 28, 2002, the Authority issued Revenue Bonds, Series 2002B, with an aggregate principal amount of $50,300,000. The proceeds are to be used to renovate, rehabilitate, improve and equip existing University facilities (including dormitory renovations and sprinkler installations), construct new facilities and finance miscellaneous capital expenditures. The Series 2002B bonds mature on July 1, 2032. The bonds are subject to optional redemption by the Authority at the principal amount plus accrued interest to the date of redemption. The bonds are subject to Mandatory Sinking Fund Redemption in payment amounts ranging from $675,000 in 2003 to $2,100,000 in 2032. The Bonds bear a floating rate of interest, which is reset by dutch auction every 35 days. The Authority has the option to convert the interest rate on the Bonds to a fixed rate.

Health Services Component

The Health Services Component has entered into a Master Trust Indenture (MTI) with respect to the indebtedness (exclusive of the PHEFA Series 2002 issued June 27, 2002) related to the assets and revenue of the Hospital of the University of Pennsylvania, the Clinical Practices of the University of Pennsylvania, the Presbyterian Medical Center of the University of Pennsylvania Health System, Clinical Care Associates, Phoenixville Hospital, Pennsylvania Hospital and the operating unit known as Managed Care/Full Risk Capitation (collectively, the designated units).

Notes to Financial Statements

The MTI and related agreements contain certain restrictive covenants which limit the issuance of additional indebtedness and, among other things, require the Health Services Component to meet an annual debt service coverage requirement of "income available for debt service" (excess of revenue over expenses plus depreciation, amortization, interest expense and extraordinary items) at an amount equal to 110% of the annual debt service requirements. In both 2002 and 2001, the Health Services Component met its debt service coverage requirement under the MTI.

On August 2, 2000, the Health Services Component entered into a reimbursement agreement with three financial institutions, whereby these institutions have agreed to provide letters of credit for the principal amount of the bonds, plus applicable interest coverage to support the PHEFA Series B of 1994, Series C of 1996 and Series B of 1998 outstanding variable rate bonds. The conditions under the reimbursement agreement permit a borrowing under the letter of credit in the event the bonds are not successfully remarketed. The Health Services Component pays commitment fees on the unused amount of the letters of credit. The University has agreed to guarantee the obligations of the Health Services Component under the reimbursement agreement with the financial institutions. In July 2002, the agreement was extended for an additional three years.

The Series of 2002, dated June 27, 2002 was issued to refinance the $18,000,000 term loan, finance certain capital projects, and to establish a debt service reserve fund. The bonds have a stated interest rate of 7.50%. The holder of the bonds will have the option to tender them, to Phoenixville Hospital, for purchase on or after June 27, 2005, as described in a put option agreement between the Hospital of the University of Pennsylvania and the Clinical Practices of the University of Pennsylvania and Merrill Lynch Portfolio Management. The 2002 Bonds are also guaranteed by the Hospital of the University of Pennsylvania and Clinical Practices of the University of Pennsylvania, for which they receive a guarantee fee. The put option and the guarantee reduce the net cost of funds to 3.45%. Simultaneously, the Health Services Component entered into a three-year interest rate exchange agreement in order to convert this fixed rate borrowing to a variable interest rate. The interest rate exchange agreement was not entered into for trading or speculative purposes. Under the terms of the agreement, the Health Services Component receives a fixed rate of 2.65% and pays a variable interest rate defined as the BMA municipal swap index on the notional principal amount of $26,065,000.

In April 2002, the Health Services Component entered into a $30,000,000 tax exempt capital lease for the acquisition of various equipment. The lease has a seven-year term at a fixed interest rate of 4.64%. Semi-annual payments approximate $2,534,000. The remaining capital lease of $1,331,000 fully amortizes in 2004 at a fixed interest rate of 5.9%. Semi-annual payments on the lease approximate $366,000.

Notes to Financial Statements

7. Natural Classification of Expenditures

Expenses incurred were for (in thousands):

	Compensation	Student Aid	Depreciation	Interest	Other Operating	Total
June 30, 2002						
Instruction	$398,027	$33,549	$25,846	$2,849	$164,734	$625,005
Research	269,119	6,052	31,124	9,221	170,958	486,474
Hospitals and physician practices	881,633	--	83,080	38,742	710,623	1,714,078
Auxiliary enterprises	20,790	--	8,248	5,577	53,148	87,763
Other educational activities	68,343	31	2,704	913	27,028	99,019
Student services	22,234	109	--	376	14,843	37,562
Academic support	22,679	--	18,751	1,110	8,707	51,247
Management and general	109,762	12	5,764	1,616	37,317	154,471
Independent operations	4,190	--	4,302	3,181	43,638	55,311
Total	$1,796,777	$39,753	$179,819	$63,585	$1,230,996	$3,310,930
June 30, 2001	$1,640,292	$34,858	$182,911	$75,661	$1,173,606	$3,107,328

8. Operating Leases

The University leases office space and equipment under operating leases expiring through October 2016. Rental expense for the years ended June 30, 2002 and 2001 totaling $37,584,000 and $36,668,000, respectively, is included in the accompanying Statement of Activities.

At June 30, 2002, future minimum lease payments under operating leases with remaining terms greater than one year were as follows (in thousands):

2003	$26,828
2004	23,222
2005	19,012
2006	16,192
2007	11,122
Thereafter	39,216
Total minimum lease payments	$135,592

9. Pension and Other Postretirement Benefit Costs

Retirement benefits are provided for academic employees and certain administrative personnel through a defined contribution plan. The University's policy with respect to its contribution is to provide up to 9% of eligible employees' salaries. The University's contributions amounted to $41,309,000 in 2002 and $37,127,000 in 2001.

The University has noncontributory defined benefit pension plans for substantially all other full-time employees. Benefits under these plans generally are based on the employee's years of service and compensation during the years preceding retirement. Contributions to the plans are made in amounts necessary to at least satisfy the minimum required contributions as specified in the Internal Revenue Service Code and related regulations.

Notes to Financial Statements

The components of accrued benefit costs for pension benefits and other postretirement benefits are as follows (in thousands):

	Pension Benefits		Other Postretirement Benefits	
	2002	2001	2002	2001
Change in benefit obligation:				
Benefit obligation at beginning of fiscal year	$430,101	$399,324	$241,042	$223,817
Service cost	12,505	11,832	12,652	10,875
Interest cost	31,676	30,233	18,776	16,721
Plan participants' contributions	--	--	701	1,120
Amendments	12,833	--	(22,651)	(9,153)
Actuarial loss	17,951	15,573	38,553	10,771
Benefits paid	(18,527)	(17,901)	(13,007)	(12,602)
Curtailments	--	(8,960)	--	(507)
Benefit obligation at end of fiscal year	$486,539	$430,101	$276,066	$241,042
Change in plan assets:				
Fair value of plan assets at beginning of fiscal year	$534,339	$522,808	$ 74,858	$ 68,334
Actual return on plan assets	3,163	31,102	(7,080)	2,625
Employer contribution	--	--	6,529	6,869
Plan participants' contribution	--	--	185	71
Benefits paid	(18,527)	(17,901)	(3,114)	(3,041)
Divestitures/settlements	--	(1,670)	--	--
Fair value of plan assets at end of fiscal year	$518,975	$534,339	$ 71,378	$ 74,858
Reconciliation of funded status:				
Funded status	$32,436	$104,238	$(204,689)	$(165,885)
Unrecognized net actuarial (gain) loss	(35,854)	(104,529)	68,979	16,367
Unrecognized prior service cost (benefit)	12,927	135	(30,120)	(8,805)
Unrecognized transition asset	(1,680)	(2,654)	--	--
Prepaid (accrued) benefit cost	$7,829	$(2,810)	$(165,830)	$(158,323)

Notes to Financial Statements

Weighted-average assumptions as of June 30, 2002 and 2001:

	2002	2001
Discount rate	7.25 %	7.50%
Expected return on plan assets	9.25 %	9.25 - 9.50%
Rate of compensation increase	4.00 - 4.75 %	4.00 - 4.75%

In 2002, the health care trend rate was assumed to decrease gradually from 8.00% to 6.00% over the next six years and remain level, thereafter. In 2001, the health care trend rate was assumed to decrease gradually from 8.50% to 5.00% over the subsequent seven years.

The components net periodic benefit cost for pension benefits and other postretirement benefits are as follows (in thousands):

	Pension Benefits		Other Postretirement Benefits	
	2002	2001	2002	2001
Service cost	$12,505	$11,832	$12,652	$10,875
Interest cost	31,676	30,233	18,776	16,721
Expected return on plan assets	(48,942)	(47,899)	(7,237)	(6,089)
Amortization of prior service cost	41	51	(1,338)	(1,101)
Amortization of transition asset	(974)	(974)	--	--
Amortization of net actuarial gain	(4,946)	(9,002)	321	(1,531)
Net periodic (benefit) cost	(10,640)	(15,759)	23,174	18,875
Curtailment gain	--	(8,897)	--	(507)
	$(10,640)	$(24,656)	$23,174	$18,368

Assumed health care cost trend rates have a significant effect on the amounts reported for the other postretirement benefits. A one-percentage-point change in assumed health care trend rates would have the following effects on other postretirement benefits:

	1-Percentage Point Increase	1-Percentage Point Decrease
Effect on total of service and interest cost	$5,674	$(4,405)
Effect on accumulated postretirement benefit obligation	$38,510	$(31,732)

Pension plan assets consist principally of investments in a master trust account, invested in a diverse portfolio of equity and debt securities. Other postretirement employee benefit plan assets consist principally of investments in a diverse portfolio of equity and debt securities.

Notes to Financial Statements

10. Medical Professional Liability Claims

The University is insured for medical professional liability claims through the combination of the Medical Professional Liability Catastrophe Loss Fund of the Commonwealth of Pennsylvania (CAT Fund), various commercial insurance companies and a risk retention program.

The CAT Fund policies are retrospectively rated on a "claims made" basis. The CAT Fund levies health care provider surcharges, as a percentage of insurance premiums for basic coverage, to pay claims and pay administrative expenses of the CAT Fund participants. These surcharges are recognized as expenses in the period incurred. In March 2002, the Pennsylvania General Assembly approved reforming the Commonwealth's medical malpractice insurance system. No provision has been made for any future CAT Fund assessments in the accompanying financial statements as the University's portion of the unfunded CAT Fund liability cannot be estimated.

The University accrues for estimated retained risks arising from both asserted and unasserted medical professional liability claims. The estimate of the liability for unasserted claims arising from unreported incidents is based on analysis of historical claims data by an independent actuary which is recorded utilizing a 6% discount rate. Assets have been board designated to provide funding for the University's retained risk associated with medical professional liability claims occurring prior to June 30, 1997, under its risk retention program. The assets are included in the accompanying financial statements.

From July 1998 through June 2001, the University was insured by a commercial insurer to provide claims made primary layer coverage on a claims made premium basis. Premiums were expensed in each respective fiscal year. Additionally, the University has recorded the actuarily determined exposure for unreported and unasserted medical professional claims that occurred during the period covered by the commercial insurance policy.

Effective July 1, 2001, the University funded RRG/Captive, for purposes of administering its Risk Retention program, covering its primary layer exposures. The assets and respective liabilities of RRG/Captive are included in the accompanying financial statements.

11. Contingencies

The University has guaranteed certain obligations, including student loans, mortgages, and leases on properties owned by related parties, totaling $154,671,000 on June 30, 2002 and $141,701,000 on June 30, 2001. Various lawsuits, claims and other contingent liabilities arise in the ordinary course of the University's education and health care activities. Based upon information currently available, management believes that any liability resulting therefrom will not materially affect the financial position or operations of the University.

The University is currently involved in various capital projects that have resulted in large capital commitments from the University. As of June 30, 2002, approximately $125,061,000 has been committed by the University.

Trustees

as of June 30, 2002

Statutory Officers

as of June 30, 2002

President
Dr. Judith Rodin

Provost
Dr. Robert L. Barchi

Executive Vice President
Mr. John A. Fry

Executive Vice President of the University of Pennsylvania for the Health System and Dean of the Medical School
Arthur Rubenstein, MBBCh

Vice President for Finance and Treasurer
Mr. Craig R. Carnaroli

Vice President and Chief of Staff
Pedro A. Ramos, Esq.

Vice President and General Counsel of the University of Pennsylvania and the University of Pennsylvania Health System
Wendy S. White, Esq.

Vice Presidents

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Mr. Omar H. Blaik, *Facilities and Real Estate Services*

Ms. Virginia B. Clark, *Development and Alumni Relations*

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Secretary of the University
Ms. Leslie Laird Kruhly

Comptroller
Mr. Kenneth B. Campbell