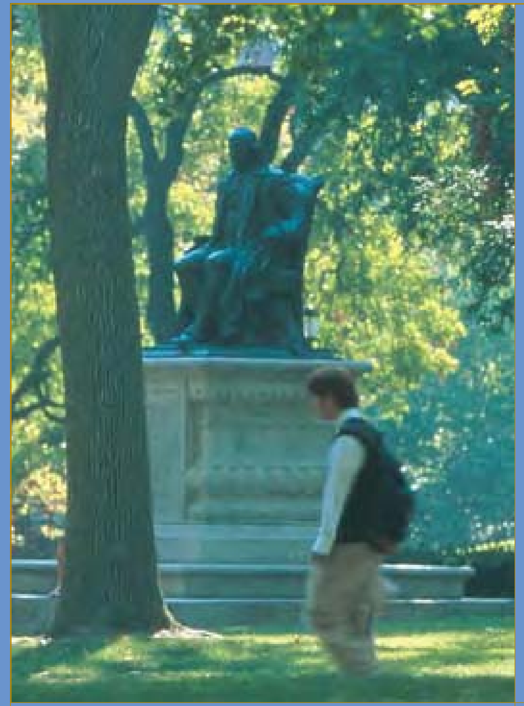
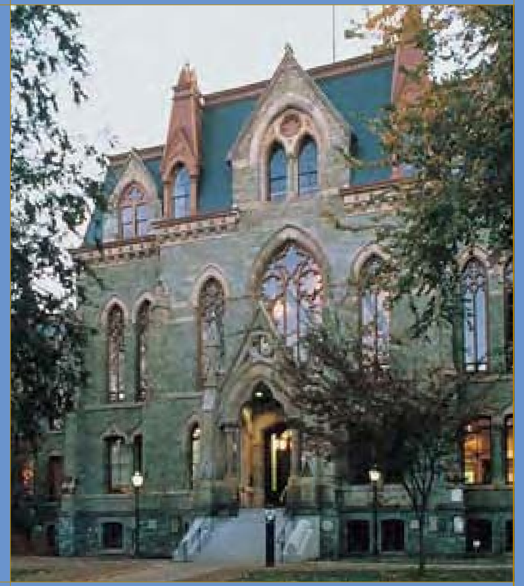
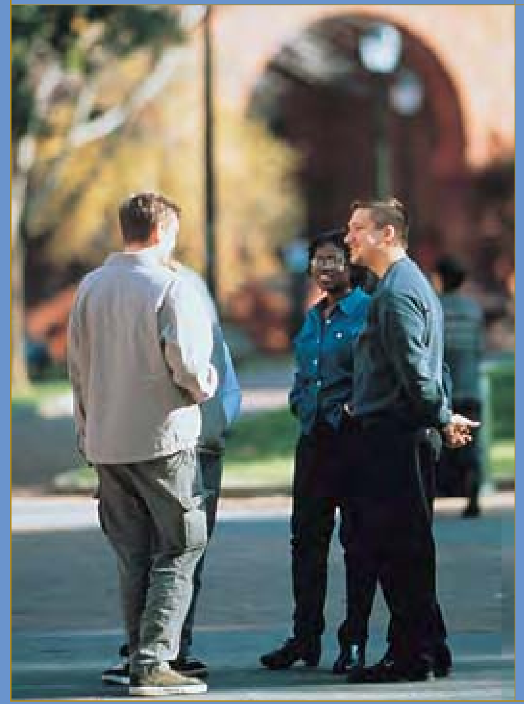
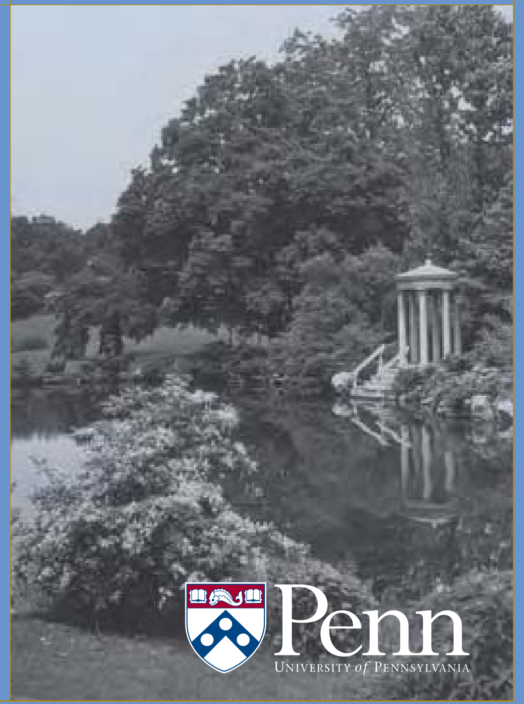


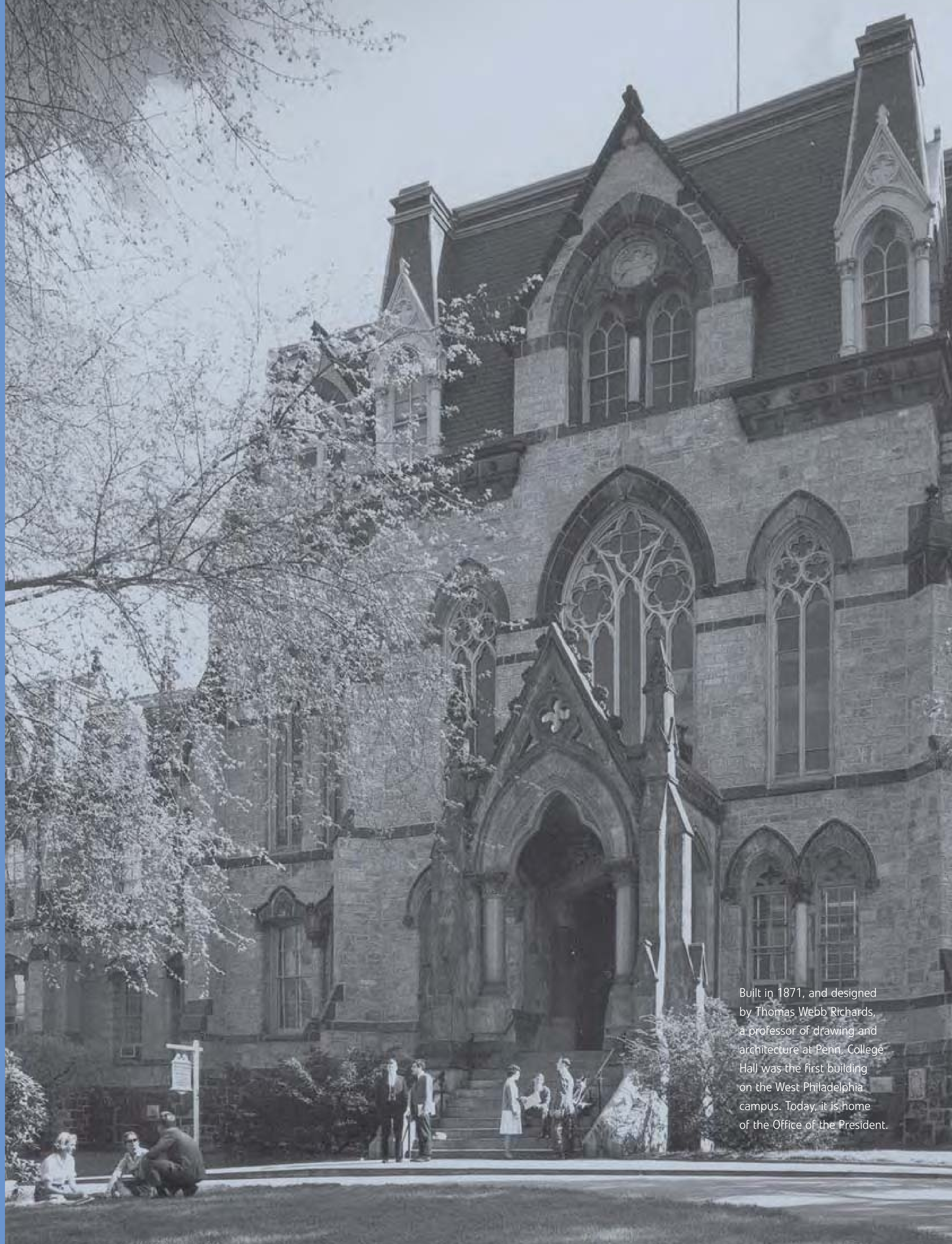
03 financial report 04







Penn
University of Pennsylvania



Built in 1871, and designed by Thomas Webb Richards, a professor of drawing and architecture at Penn, College Hall was the first building on the West Philadelphia campus. Today, it is home of the Office of the President.

The President leads an institution dedicated to providing educational and research opportunities for some 23,000 students enrolled in Penn's 12 undergraduate, graduate, and professional schools.

1930 1944
Thomas Sovereign Gates

During his presidency, Penn established the College of Liberal Arts for Women. A total of 4,881 Penn students, alumni, faculty and staff entered the armed forces by the first anniversary of the attack on Pearl Harbor. The Fels Institute for Local and State Government was established among many other accomplishments.

1944 1948
George William McClelland

The United States was in a booming post-war economy. During this time, McClelland reinstated the Penn Fund and launched a $32 million campaign for campus expansion and beautification, which included new buildings for the University Library, the Wharton School, the departments of Physics, Math and Astronomy, women's dormitories, as well as the School of Medicine and HUP.

1948 1953
Harold Edward Stassen

Stassen continued to fulfill McClelland's campus expansion plans while diversifying the student body and improving student life and raising academic standards. He revised admission policies to attract applicants from a more diverse economic, racial, religious, geographical and national background.

1953 1970
Gaylord Probasco Harnwell

Harnwell streered Penn through the tumultuous 1960s when the nation and campus grieved over assassinations and protested the Vietnam War. He systematically evaluated Penn's educational practices. In response to the findings, he strengthened Penn's undergraduate liberal arts component and encouraged research as part of teaching.

1970 1981
Martin Meyerson

Meyerson introduced a comprehensive affirmative action plan to increase the number of women and African Americans on the faculty and staff as well as on campus. He led an effort to merge the College, the College for Women, the Graduate School of Arts and Sciences and the Social Science Programs to highlight Penn's new theme of being "One University."

1981 1994
Francis Sheldon Hackney

Hackney's administration raised over $1 billion for Penn's endowment during a time when funds for higher education were cut in the United States. He also designed and implemented plans for University-wide interdisciplinary studies.

1994 2004
Judith Seitz Rodin

Rodin's tenure saw a phenomenal rise in resources as research awards, contributions, and the endowment all multiplied. Under Judith Rodin's leadership, Penn advanced from 16th to 4th in the *U.S. News and World Report's* annual ranking of American Colleges and Universities. She improved educational programs with her plan "Agenda for Excellence", while also improving the surrounding community through the West Philadelphia Partnership.

"Presidential timeline courtesy of the University Archives and Records Center."

Aerial view of campus, 1934

the presidency at penn

In the year of our country's fifty-fifth Presidential election, we highlight 2004 financial results in the context of the Presidency at Penn. Penn has had seven presidents since the establishment of the office by the Trustees in 1930. Prior to the establishment of the Office of the President, the Chief Executive Officer of the University was the Provost.

It is also appropriate to focus on the Presidency at Penn as we welcome Dr. Amy Gutmann as Penn's eighth president, beginning in July 2004. She joins us as Dr. Judith Rodin, who led the institution with tremendous success since 1994, steps down.

The President of the University of Pennsylvania leads an institution dedicated to providing education, research, and service for some 23,000 students enrolled in 12 schools, with more than 4,400 faculty. She also represents the University to external constituencies on issues related to Penn and on higher education in general. The President also serves as the ambassador of the University to Penn's more than 270,000 alumni. The President works with deans, administrators, and alumni in efforts designed to attract philanthropic support from individuals, corporations, and foundations. Many of Penn's new buildings and landmark restorations – from Huntsman Hall to Perelman Quadrangle – were made possible by major gifts from prominent alumni.

The President is the chief executive of the largest private employer in Philadelphia and the second largest in Pennsylvania. She is responsible for the financial health of the University, and oversees one of the largest integrated academic health systems in the country. Similarly, the President is the chief architect and steward of Penn's thriving partnership with the West Philadelphia community.

From Benjamin Franklin to our current leadership, the University of Pennsylvania has been led by distinguished men and women for more than 250 years. This report focuses on some of the key highlights and events that occurred during our past Presidents' tenures which contributed to Penn's prestige as a premier institution of higher education and healthcare.

at-a-glance

Student Enrollment
Undergraduate students 11,958
Graduate and professional students 11,337

Undergraduate Admissions Statistics
Applications 18,282
Percent accepted 21.2%
Percent matriculated 62.7%

Faculty
Standing faculty 2,440
Associated faculty 2,059

Financial Summary
Total operating revenue $3,723,344
Total operating expenditures $3,716,145

Principal Sources of Revenue
Tuition and fees (net) $518,992
Sponsored programs $678,724
Hospitals and physician practices $1,949,818
Contributions $253,175
Investment income* $548,076

Principal Purposes of Expenditures
Instruction $721,299
Research $549,404
Hospitals and physician practices $1,908,452

Endowment
Market value $4,018,660
One-year endowment performance 16.8%

Net Assets
Unrestricted $2,871,551
Temporarily restricted $1,422,228
Permanently restricted $1,593,941

Dollars in thousands

* Includes gains and losses on investments

table of contents

message from the senior vice president for finance and treasurer

The end of the fiscal year provides the occasion to reflect on our accomplishments, refine our business strategies and refocus our energies on future ambitions. Penn's FY 04 accomplishments include the endowment surpassing the $4 billion threshold, the Health System's fourth consecutive year of positive operating performance, and Penn's advance to #4 in the *U.S. News & World Report* ranking of America's best colleges and universities.

During FY 04, the consolidated University achieved positive financial performance as measured by its growth in net assets. Growth was fueled primarily by strong investment performance and contributions. The endowment experienced substantial financial growth during the past fiscal year. Investment returns experienced strong growth as equity markets rebounded on signs of an improving economy. Performance exceeded internal benchmarks by more than 2 percentage points. The strong support of our alumni, friends, corporations, foundations, and associations continued as endowment contributions increased over prior year levels. In particular, non-operating contributions – which include gifts for endowment and capital – exhibited robust growth.

The quality of the incoming undergraduate pool remained strong as applications surpassed the 18,000 mark for the fifth consecutive year. Of the 21% of applicants offered admission, nearly 63% chose to attend Penn. The average SAT score for matriculated students was 1413 for the incoming freshman class.

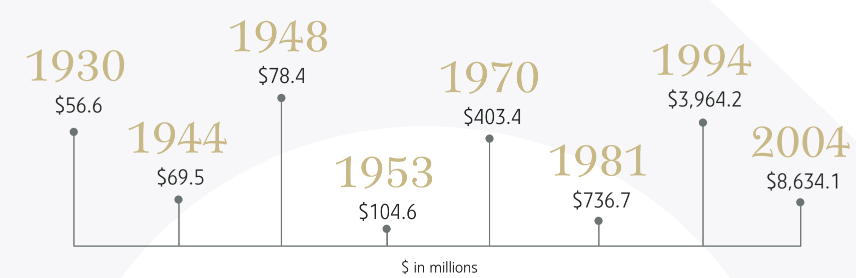
Sponsored program revenue continued to grow, although this rate has declined from prior years' double-digit growth levels as the five-year doubling of the National Institutes of Health budget came to an end in FY 03. New awards grew by over 5% as Penn strives to diversify the source of research funds.

Cost control measures were successful on a number of fronts. For example, employee benefits cost, which has been growing at double digits, actually moderated in FY 04 as a result of benefit redesign initiatives and prescription drug management, including the greater use of mail order prescription services. Penn also continued to leverage its procurement capabilities through continued development of the Penn Marketplace and other e-procurement initiatives. Seventy-one new suppliers were added to the Penn Marketplace in FY 04.


Cardiovascular and pulmonary research, 1951


Penn classroom, 1960

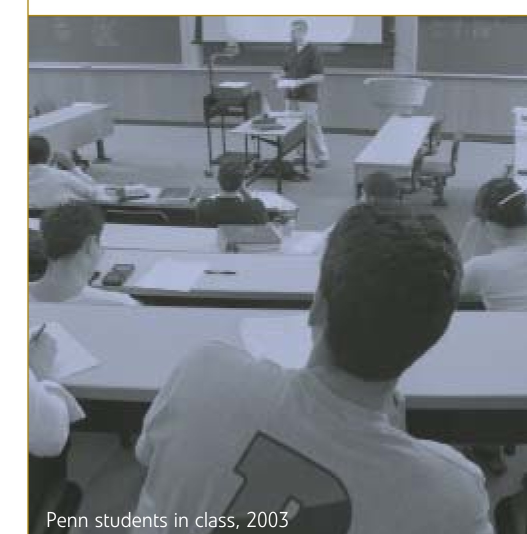
Net asset growth was attained through strong Health System utilization led by adult admissions, particularly surgical admissions. This consistent, positive operating performance has enabled the Health System to begin focusing on future capital expansion. For example, planning for the Riverview Center for Advanced Medicine which will be located on the Civic Center site is well underway and when completed will provide additional space for patient services and other ambulatory programs.

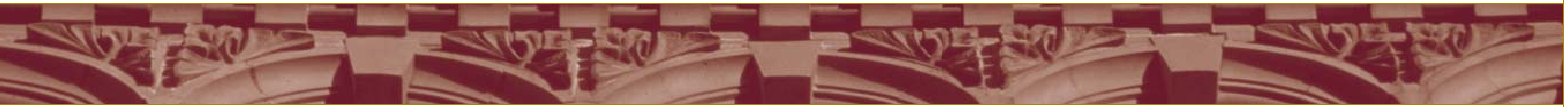


total assets


Ravdin Institute operating room, 1969


Wharton students leaving Logan Hall, 1948


Penn students in class, 2003



Locust Bridge, 1973

fiscal year 2004 performance highlights

Total net assets increased $559.2 million for the fiscal year, principally due to investment performance and contributions. Penn concluded the fiscal year at June 30, 2004 with total assets of $8.6 billion, total liabilities of $2.7 billion, and net assets of $5.9 billion.

The University's total revenue increased $223.1 million, or 6.4%, to over $3.72 billion. The Health System constituted 76.7% (or $171 million) of this overall growth in revenue, reflecting increased adult admissions, patient volumes and overall patient activity. Sponsored program revenue (including indirect cost recovery), principally in the School of Medicine, grew $32.1 million, or 5.0%, year-over-year. Tuition and fees (net of student aid) grew $31.1 million (6.4%).

Total gifts and pledges (excluding private grants) exceeded $253 million in FY 04. Operating contributions declined $12.7 million or 12.6% compared to FY 03 levels. Non-operating contributions – which include gifts for endowment and capital – increased by $17.9 million.

Overall, total expenses increased $244.2 million or 7.0%. Consistent with educational financial reporting practices, expenses in the University's audited financial statements are reported on a "functional" basis. Hospital and physician practice expenses accounted for 64% of total growth, increasing $156.1 million or 8.9%. Instruction and research expenses combined grew at an approximate 5% rate of growth. Management and general expenses increased $0.2 million, or 0.1%, primarily due to increases in external insurance costs and depreciation.

The consolidated University achieved an increase in net assets from operating activities of $7.2 million, a decline of $21.2 million from FY 03. For the academic component, the decline can be attributed to the expenditure of operating gifts received and recorded in prior fiscal years as well as some other non-recurring items. For the fourth consecutive year, the Health System generated positive net income from operations.

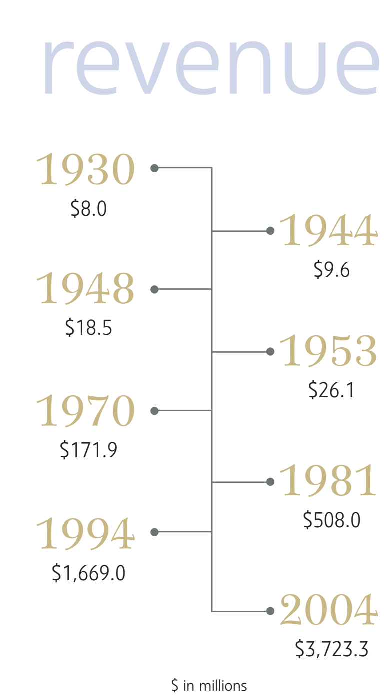
Consolidated University net assets from non-operating activities increased by $552.0 million due principally to gifts for capital and endowment and positive investment performance.

The endowment returned 16.8% for the fiscal year ending June 30, 2004, resulting in its crossing the $4 billion mark. This return is roughly 2.5% ahead of our composite benchmark. Equity and credit strategies did particularly well as did non-dollar asset strategies. Outperformance was driven by strong manager returns in international equities and in diversifying assets (hedge funds). Tactical asset allocation also contributed to performance.

Short-term working capital, measured by operating cash, grew by $139.6 million in part to advances received on grants and improvements in the collection of receivables at the University and the Health System. Days in accounts receivable at the Health System declined to 71 days at June 30, 2004.

Plant assets, net of depreciation, increased by $18.7 million. Long-term debt decreased by $24.6 million due to the scheduled retirement of University and Health System debt, offset by modest additional indebtedness incurred when refinancing two existing debt issues for the University. Significantly, the University's credit rating was upgraded by Moody's to Aa3 from A1 during the year.

Cash flow from operating activities totaled $328.1 million and exceeded FY 03 levels by $4.8 million. Purchase of property, plant and equipment exceeded $250.0 million, a decrease of $24.5 million from FY 03 activity.



Dietrich Hall classroom, 1960

Wharton classroom, 1900

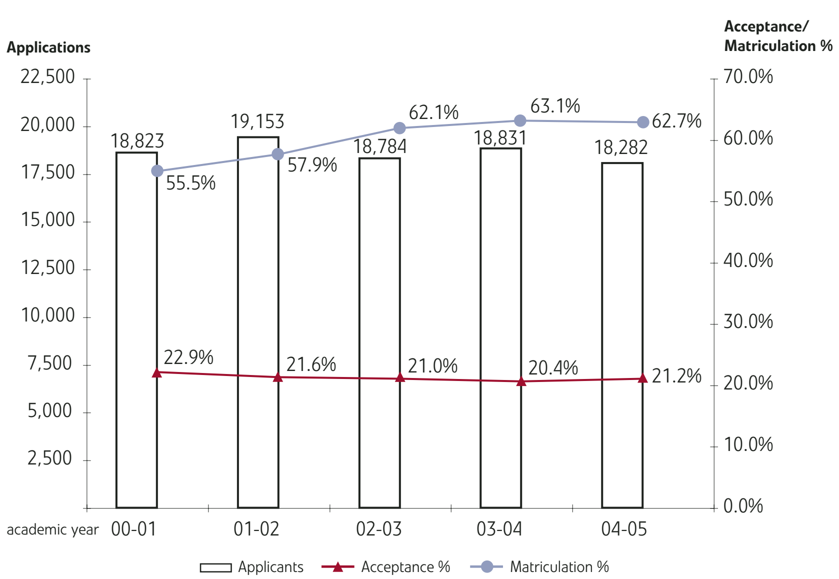
Conversation on campus, 2002

tuition, fees and financial aid

Tuition and fees (net of student aid) comprise nearly 14% of Penn's total revenue. Penn earns tuition dollars from its undergraduate, graduate and professional programs. It also earns tuition revenue from a number of other special programs such as study abroad and executive education.

Penn encourages study – both on campus and abroad – of the world's peoples, economies, and environments and their interdependence. Study abroad programs enable a deeper understanding of other cultures and languages. Every year, more than 600 students spend a semester or year abroad as an enriching part of their formal undergraduate education.

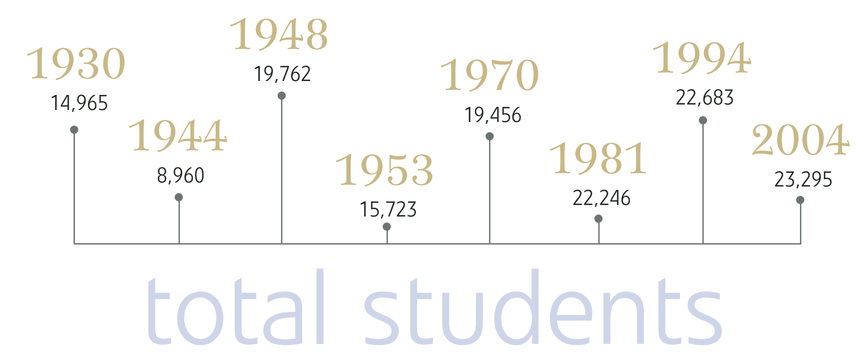
Undergraduate Applications / Admission Statistics



Penn's executive education programs continue to play a strategic role in Penn's focus on "lifelong learning." For example, the Wharton School's west coast campus in the San Francisco business district offers executive education courses, as well as an MBA program for executives. The School of Medicine's accredited Continuing Medical Education (CME) program provides physicians and other healthcare professionals with clinical updates and insight into the latest research across all therapeutic areas.

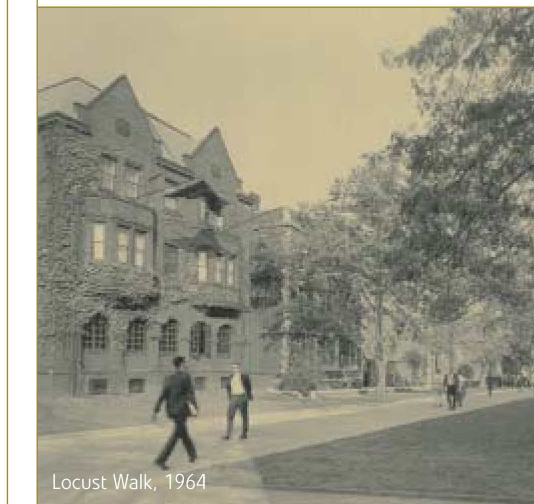
A secondary source of revenue is the collection of fee income to support student programs and services. Examples of such include fees related to admission, registrar and student financial services, student transportation, information technology, recreational facilities and student health insurance. For example, information technology fees support wireless connectivity at Penn, which provide the convenience of connecting to the University's data network. Penn's wireless network is being implemented in phases focusing first on areas of campus where students congregate and interact.

In an effort to make a Penn education available to outstanding students, Penn continues to build on its commitment to need-blind admission and need-based financial aid. In 2003-2004



approximately 70% of all University students received some type of financial assistance. Approximately 56% of those students received a total of $115 million in grant aid. This consisted of $84 million from the University and $31 million from federal, state, and private sources. This grant aid does not include an additional $81 million in teaching/research fellowships and assistantships, departmental grants and tuition remission for members of faculty, staff and their dependents matriculating at the University.

In 2003-2004, over 4,300 undergraduates with financial need were awarded aid to meet their needs. Unfortunately, only 12% of University-funded undergraduate grants are covered from endowment income, resulting in dependence on the general operating budget to cover much of our aid expenses. In the five-year fiscal period 1999-2004, financial aid from endowment funds increased by 141%, while funding from general funds increased by only 27%. During the same time period, the average direct grant to aided freshmen rose by 34%, while the average loan fell by 34%.


Locust Walk, 1964


Hill House lounge, 1960

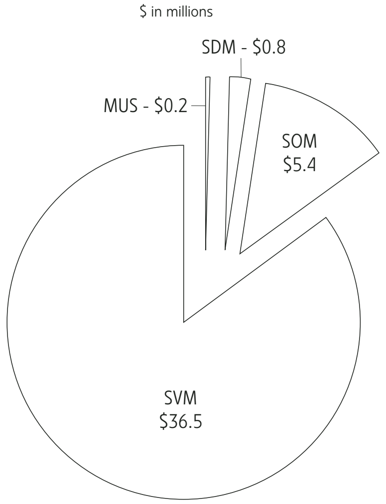

Wharton West students, 2003

commonwealth appropriations

Each year the Commonwealth of Pennsylvania invests in the future of education through an annual appropriation to the University of Pennsylvania. Although the University has no statutory relationship with the Commonwealth of Pennsylvania, it has, pursuant to specific legislative appropriations, received sums from the Commonwealth for its support and maintenance and for other specific purposes in each year since 1903. Approximately $43 million of the total unrestricted revenue of the University for FY 04 was provided from Commonwealth appropriations. The Pennsylvania legislature has appropriated approximately $44 million to the University for FY 05.

The primary beneficiary of the appropriation for FY 04 was the School of Veterinary Medicine (SVM), which received $36.5 million. Support was also provided to the School of Medicine (SOM) – $5.4 million, the School of Dental Medicine (SDM) – $0.8 million, and the University of Pennsylvania Museum of Archaeology and Anthropology (MUS) – $0.2 million.

Fiscal Year 2004
Commonwealth Appropriations
$ in millions



Agriculture is the foundation of Pennsylvania's economy. The School of Veterinary Medicine with its emphasis on food animal health, productivity, and economics provides continuing benefits to the Commonwealth. SVM, the Commonwealth's only school of veterinary medicine, is internationally recognized in veterinary medical education and for its furtherance of veterinary and biomedical research. SVM contributes greatly to the welfare of the citizens of Pennsylvania by delivering highly sophisticated veterinary care in its two acclaimed hospitals – the Matthew J. Ryan Veterinary Hospital in Philadelphia for Companion Animals, and the George D. Widener Hospital for Large Animals at the New Bolton Center in Chester County. SVM's food animal programs include the Widener Hospital, a field service/ambulatory clinic, nutrition and animal health economics, food animal reproductive programs in the Laboratory of Avian Medicine, and the Laboratory of Large Animal Pathology. The state-of-the-art Marshak Teaching and Research Dairy, the first solar dairy in Pennsylvania, provides a model of productivity and nutrient management for the dairy industry in the Commonwealth.

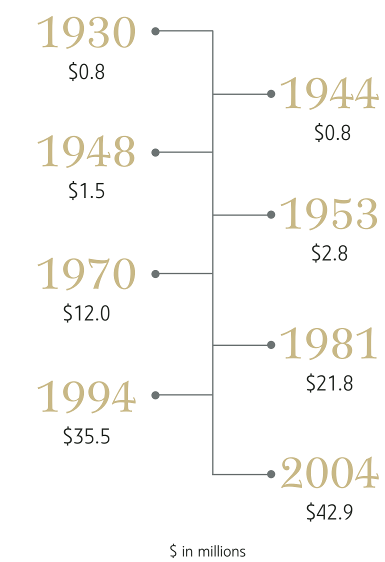
The School of Medicine's FY 04 Commonwealth appropriation was used to support the program of medical student education. The funds were allocated to the SOM's academic programs offices and academic departments and were used to pay for various educational costs. These include the continued development and implementation of a medical student curriculum for the twenty-first century and supporting technologies; support of student financial aid for Commonwealth residents; and personnel and operating expenses for curricular and student services, community health care educational and supportive services, and enhancement of medical student recruitment and retention activities.

The School of Dental Medicine uses its appropriation to help support dental providers and the operating costs of the emergency service and clinics which provide excellent and affordable dental care to low-income individuals within Philadelphia and from neighboring counties. SDM also uses its PennSmiles mobile van to address the oral health needs of children in the community.

The University of Pennsylvania Museum of Archaeology and Anthropology, which was recently named by *Discover Magazine* as one of the world's ten great science museums, provides outreach and public programming. Residents of 57 counties in the state benefit from the Commonwealth Lecture program, while students benefit from the "Museum on the Go" program, which delivers guides and artifacts to elementary and middle schools.

Evans Institute Dental School, 1915

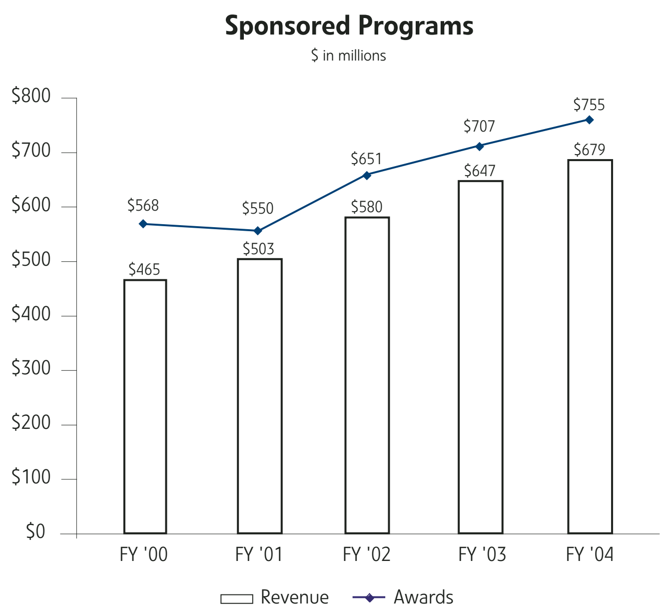
appropriation



University Museum, Mediterranean Section, 1905

New Bolton Open House, 1976

sponsored programs



Sponsored program activity provides over 18% of the University's total revenue. Sponsored program support includes the direct and indirect costs of sponsored research activity. In FY 04, sponsored program revenue totaled $679 million, an increase of over $32 million (5.0%) compared to FY 03. The indirect cost component grew by $9 million to $171 million, an increase of 5.7%. Total awards received reached $755 million, a 6.8% increase from last year's record of $707 million. A total of $482 million in awards were received from the Department of Health and Human Services, primarily the National Institutes of Health (NIH), Penn's largest sponsor, for research, training, fellowships and other programs. Penn ranked third in NIH funding for the latest available federal fiscal year (FY 03).

Over the past ten years, Penn has seen significant growth in sponsored program funding. In FY 94 the University received $280 million in awards, compared to over $755 million received in FY 04. This $475 million increase over the decade represents an annualized growth rate of over 10.4%. Penn benefited significantly from several years of substantial NIH budget increases that ended in FY 03. However, the future NIH budget is programmed for only modest annual increases of 2-3%. Nevertheless, the University is seeking to broaden its sources of support to offset a leveling-off of NIH funding. Foundation and industry support alone grew a combined 26.3%, from $118 million in FY 03 to $149 million in FY 04.

There are many examples of Penn research with broad applicability, including the research funded by the National Science Foundation for a new Nanoscale Science and Engineering Center (NSEC). As part of the NSEC program, Penn's new Nano/Bio Interface Center will bring together researchers from across campus to study the intersection of technology and biology at the nanoscale – or molecular – level. "As electronics and machines are driven ever smaller, they will inevitably be integrated with biological systems, which will have dramatic technological, biomedical and social implications", notes Dawn Bonnell, a professor at Penn in the Department of Materials Science and Engineering and director of the new center. "The new center will bring together Penn's renowned strengths in nanotechnology and the life sciences, as well as lead the national discussion on the ethical considerations surrounding nanoscale science and its potential impact on humanity." In addition to its cross-campus partnerships, the Nano/Bio Interface Center will actively collaborate with other nanotechnology initiatives nationally and internationally. These partners include Drexel University, the Center for Integrated Nanostructures at Sandia and Los Alamos National Laboratories, the Nanotechnology Institute, the Technical University of Dresden, Germany, and both Cambridge University and the University of Birmingham in the UK.


College for Women classroom, 1940


ENIAC Computer, 1943-1944


Penn research students, 2001

sponsored programs

1930
$–

1944
$3.1

1948
$1.4

1953
$2.7

1970
$41.9

1981
$102.6

1994
$227.4

2004
$678.7

revenue $ in millions

development and alumni relations

Penn's fundraising program once again benefited from the generosity of its alumni and friends, with $253.2 million in new gifts and pledges and $243.9 million in gift receipts. Annual giving programs produced a record $38.4 million in unrestricted support for the University. Gifts to The Penn Fund totaled $16.5 million, an increase of 17% over FY 03.

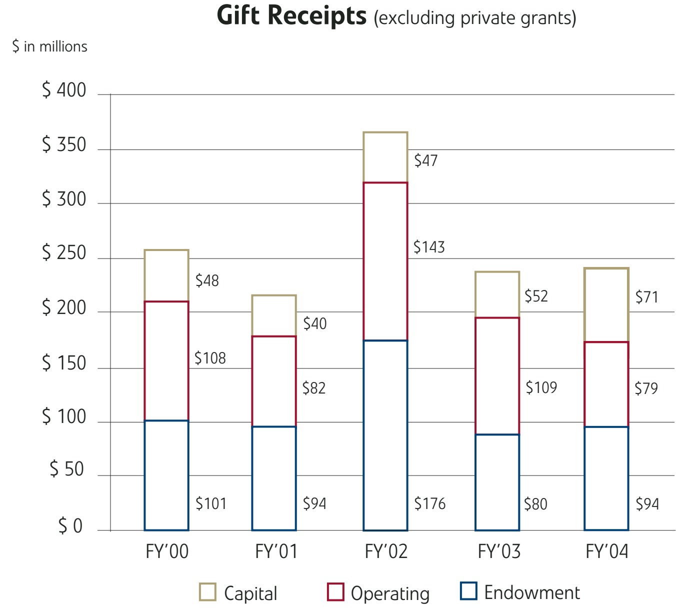
New gifts in the $1 million – $5 million range were particularly strong, with 66 gifts of $1 million or more recorded during the year. Twenty-eight of those gifts came from first-time donors at that level, compared to 12 such gifts the previous year.

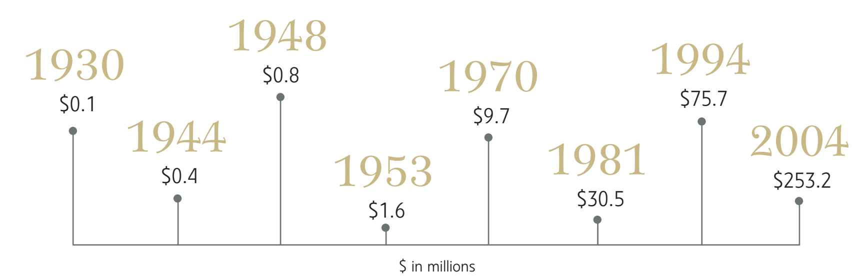
Designated gifts from current Penn parents jumped to $25.4 million from $18 million in FY 03. The Parents Fund, which provides unrestricted support, raised $1.6 million, an increase of 23% over last year's results.

FY 04 marked the successful conclusion of the Campaign for Financial Aid, which raised $205 million in new endowment gifts and pledges for undergraduate scholarships. During the eight-year campaign, Penn's $80 million endowment, which funded 150 scholarships in FY 97, grew to more than $289 million, funding more than 1,075 scholarships. Financial aid will continue to be one of the University's highest priorities in the years ahead.

Alumni engagement and participation in the life of the University continued to grow, thanks to a number of strategic initiatives. Increased academic programming during Alumni Weekend 2004 played a major role in drawing 10,000 alumni back to campus, a new record and a 40% increase over two years ago. Bi-monthly distribution of *Red and Blue Online* to e-mailable alumni expanded to 90,000. The Global Alumni Network hosted more than 75 events worldwide, reinforcing the University's commitment to a lifetime of engagement and enrichment for Penn's alumni.

Gift Receipts (excluding private grants)





philanthropy

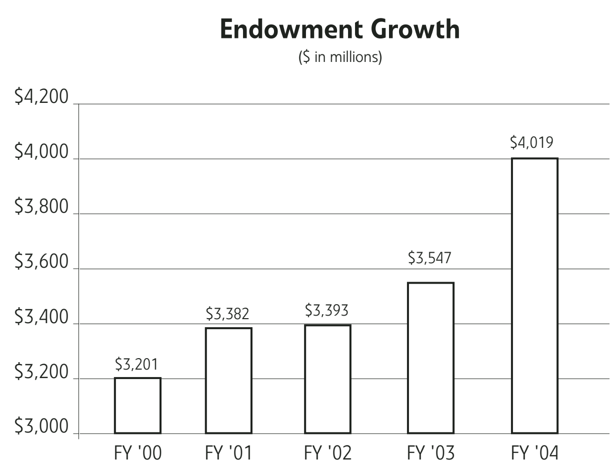

Student commencement North Broad Street, 1917


Alumni weekend, 1984


Alumni weekend, 2002

Class of 1887 twentieth reunion, 1907

endowments and investments



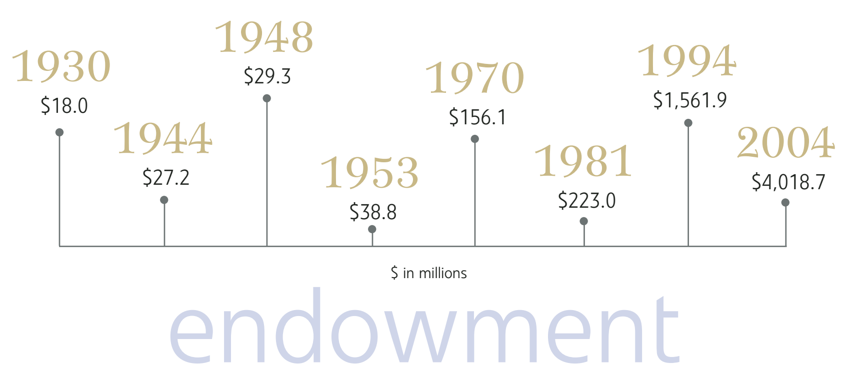
Penn's endowment ended the fiscal year 2004 with $4.019 billion in investment assets. The Associated Investments Fund (A.I.F.), in which about 84% of the endowment is invested, ended the FY 04 with a 16.8% gain, outperforming its composite benchmark by 2.5%.

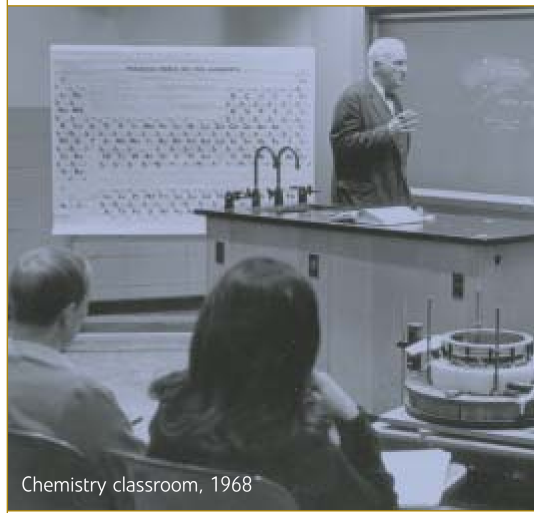
FY 04 performance was driven by a strong rebound in equity markets on signs that the economy was finally improving. Penn's domestic equity portfolio returned 21.5%, while its international portfolio returned 35.8%. Absolute return strategies returned a solid 14.4%. For the first time in several years, fixed income was essentially flat with interest rates at historic lows and all signs pointing to rising interest rates.

Over the past three fiscal years, Penn gained 6.9% per annum, significantly ahead of its composite benchmark of 3.4%. This puts Penn in the top quartile of returns on endowment with over $1 billion in assets, as reported by Cambridge Associates.

Penn's cumulative performance over the last three fiscal years is a gain of 22.3%. Over the same period, the composite benchmark's cumulative performance was a gain of 10.5%. A hypothetical portfolio invested 70% in the Dow Jones Wilshire 5000 stock index and 30% in the Lehman Government/Credit bond index would have produced a cumulative gain of 9.0%.

In FY 04, the A.I.F.'s contribution to operating income declined by $1.6 million as a result of the spending rule formula used for endowment distributions. The spending rule formula, based on the average market value for June 30, 2000, 2001, and 2002, produced a 5.0% lower distribution than for 2003 due to the difficult market environment of the three-year period.




Chemistry classroom, 1968

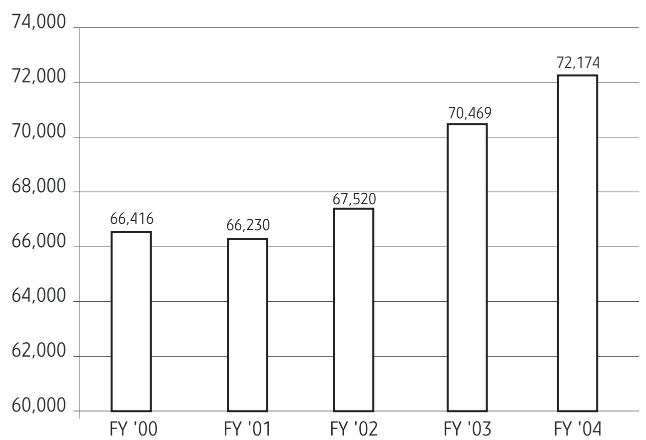

Van Pelt Library, 1964


Professor John Wideman, 1968


Locust Walk, 2003

university of pennsylvania health system

Adult In-Patient Admissions*



* Excludes Phoenixville Hospital admissions, divested August 1, 2004

In FY 04, the University of Pennsylvania Health System, comprising the health-services component of PENN Medicine, strengthened its financial performance significantly. For the fourth consecutive fiscal year, UPHS generated a surplus, with a net operating margin of $39.1 million (excluding investment income). The Health System exceeded its budget by $13 million – while exceeding the previous fiscal year's budget by $20.1 million. This performance was achieved during a year in which UPHS provided $168 million in uncompensated and undercompensated care. Outpatient visits involving the Penn hospitals and the faculty practices (Clinical Practices of the University of Pennsylvania – CPUP) increased by 3.2% and admissions increased by 2.3%.

The Health System's strong operating performance was attained in part through measures undertaken to increase revenue and reduce expenses, including malpractice costs, which have risen dramatically in recent years. The Commonwealth provided relief from these escalating malpractice costs through the abatement of premiums for certain high-risk physician groups. In May 2004, the Health System began work with an external consultant, in an effort to continue to improve its revenue cycle performance.

In FY 04, both HUP and Presbyterian passed surveys by the Joint Commission on Accreditation of Healthcare Organizations (JCAHO) as well as the Pennsylvania Department of Health. In addition, HUP's Stroke Center received national certification from JCAHO as a Primary Stroke Center.

For the eighth consecutive year, HUP was named to the Honor Roll of American Hospitals by *U.S. News & World Report*. It was one of only 14 hospitals in the country to receive this honor and the only one in the Delaware Valley. *U.S. News* also commended HUP in 15 medical specialties.

Presbyterian Hospital was listed among the top 100 cardiovascular hospitals in the country for the second year in a row by Solucient, a company specializing in health-care information. Presbyterian and HUP were designated as two of the top 100 "Performance Improvement Leaders" among American hospitals. HUP received an H2E Partner for Change award, presented by Hospitals for a Healthy Environment, a voluntary program designed to help health-care facilities enhance safety in the work place and reduce waste and waste-disposal costs. For the fourth year in a row, *Hospitals & Health Networks*, a publication of the American Hospital Association, selected UPHS for a "Most Wired" award. The Health System also was honored with a Pathfinder Award from McKesson, an information-technology company, for significantly improved clinical, financial, or strategic outcomes.

In June 2004, the University Trustees approved the initial funding to begin planning of the Center for Advanced Medicine. This major expansion project will ultimately provide 1.2 million square feet for the patient services of the Abramson Cancer Center and other tertiary-care ambulatory programs. The first phase will be a state-of-the-art facility to be built on the site of the former Convention Hall. A major fund-raising campaign to support the Riverview Project is off to an excellent start.

Medical class, 1947

John Morgan building, 2003

Medical Center Research Center, 1962

health system revenue

1930
$0.1

1944
$0.4

1948
$3.2

1953
$5.2

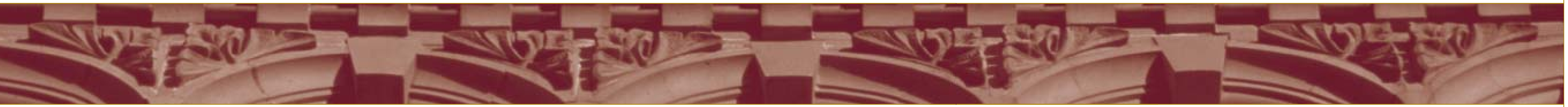
1970
$45.1

1981
$178.5

1994
$779.8

2004
$1,949.8

$ in millions

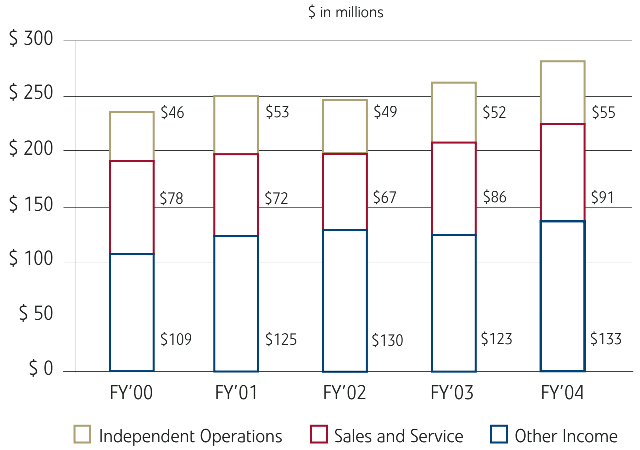


other sources of income

The majority of Penn's revenue stream is specific to the academic, research and health fields. Ancillary businesses provide operational and financial synergies to that core mission. The financial statement reflects those revenue in the Other Income, Sales and Service Income and Independent Operations categories in the revenue section of the Statement of Activities. Ancillary programs account for $278.5 million, or 7.5%, of the University's total consolidated revenue.

Other Sources of Income

$ in millions



Academic-related activities account for $117.4 million of sales and service revenue and include dormitory rent, dining services and executive education room and board. Approximately 6,000 undergraduates and 1,000 graduate students reside in the twelve college houses and three graduate residences located on Penn's campus. Students can choose from a number of residential and retail dining options. Dining programs are managed by Philadelphia-based ARAMARK Corporation, which specializes in food and facility management and offer its services to the students, faculty, and staff of Penn. Meal plan costs average approximately $3,600 per academic year.

Commercial-related activities account for $99.4 million of the University's total income and include revenue associated with parking, the Penn Computer Connection, University City Associates, the Inn at Penn, the Penn Club of New York, and Technology Transfer Licensing. Parking revenue is driven primarily by the sale of parking permits to Penn faculty, staff, and students. The Penn Computer Connection is the campus computer retail outlet which offers educational discounts on computers, hardware, software, accessories, and supplies. University City Associates manages the real estate properties owned and rented by the University of Pennsylvania. The Inn at Penn is the University's full service hotel located in the heart of Penn's campus in West Philadelphia. The Penn Club of New York is a 13 floor hotel located in midtown Manhattan. Technology transfer is the result of the commercialization of intellectual property developed by University research.

Health-related activities account for $61.7 million of other income and are associated with patient and animal care programs. Animal care revenue include fees paid by private individuals who bring their pets and animals to the Ryan Veterinary Hospital or the Widener Hospital for Large Animals. Patient care revenue are generated primarily from the Living Independently for Elders (LIFE) nursing program. LIFE is an adult day health center for managing the medical, functional, and psycho-social problems faced by elderly patients.

Morris House dorm room 1968

School of Veterinarian Medicine, 1996

other income

1930
$1.2

1944
$2.4

1948
$3.1

1953
$3.1

1970
$21.9

1981
$43.1

1994
$116.5

2004
$278.5

$ in millions

Houston Hall, semi-aerial photograph, 1915

Hey Day, 1940

capital investment

Capital investments made in 2004 continued to support Penn's multi-faceted mission and its many constituents. On the academic side, the several-year renovation of the undergraduate high-rise dormitories saw the completion of the Hamilton House project, with Harrison House near completion and Harnwell House at the start of its renovation. The renovations, in which each building is largely being completed during two summers, include window replacement, sprinklers and fire alarm installation and upgrade, common area renovation, painting and furnishings.

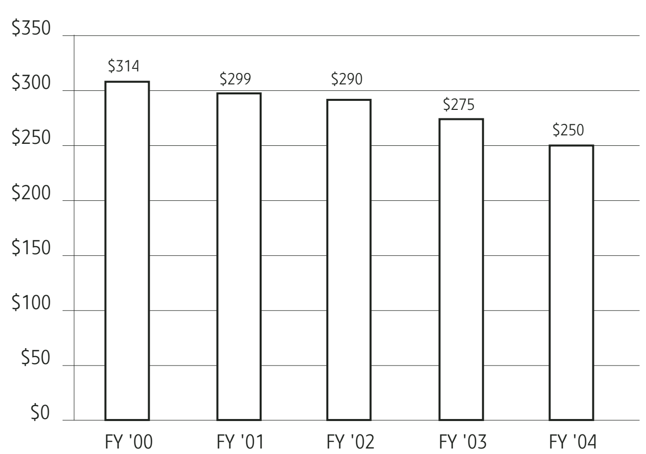
In terms of research space, the School of Veterinary Medicine began the construction of the new teaching and research building, which was expanded in scope to include lab space and vivariums for the School of Medicine, while progress on the School of Arts and Sciences' Life Sciences Building and the School of Engineering and Applied Science's Skirkanich Hall continued. The Translational Research Facility, built by an external developer adjacent to Penn's campus, was largely completed this year and offers state of the art research space for its School of Medicine tenants.

With respect to school and classroom projects, the Annenberg School for Communication renovated its plaza and classrooms. The School of Arts and Sciences completed the renovation of Williams Hall, started renovation on Bennett Hall, and began the design of the new McNeil Center for Early American Studies.

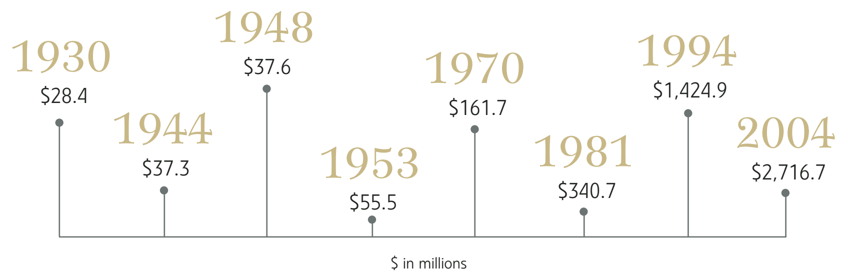
We continue to make capital investments in our information systems. In FY 04, the initial phase of the Penn ERA (Electronic Research Administration) system was rolled out, while early stage development took place for a new advancement system. In addition, a student borrowing management system to enhance the student loan application and tracking processes and a system to simplify the process of effort reporting for research grant compliance were also initiated.

Purchase of Plant, Property, & Equipment

($ in millions)



Back of College Hall, 2001



plant & equipment

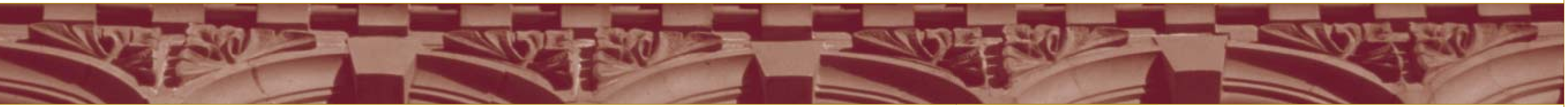
The Health System also made capital investments in its hospitals and clinical practices. For example, the development of an Operating Room Tactical Plan at the Hospital of the University of Pennsylvania (HUP) creates four new operating rooms and provides for significant upgrades to electric and HVAC systems. The Widener Building project (Pennsylvania Hospital), whose overall goal is to upgrade and replace intensive care units, includes construction of approximately 45 critical care rooms in its third phase. Presbyterian Medical Center is expanding its surgical capacity with the addition of two operating rooms. The dedication of the Rodebaugh Diabetes Clinic (CPUP) marks the expansion of this center for the treatment and prevention of diabetes.

Presbyterian Hospital, Children's Ward, 1942

Bennett Hall, 1947

Dormitories, High-Rises, 1971

Penn's bookstore, 1998



summary and future outlook

FY 04 was another successful year for the University of Pennsylvania on many fronts. Our faculty and students continued to receive recognition and awards reflecting their outstanding scholarship. Gift revenue grew over FY 03, while the endowment returned 16.8% and surpassed the $4 billion level. Tuition and grant revenue remained strong. Finally, the Health System posted its fourth consecutive year of positive operating performance.

The outlook for the near term is one of ever-greater, yet manageable, challenges. External research funding is exiting a period of rapid growth. Ten years ago, revenue derived from research activities totaled approximately $200 million per year; today that number is close to $700 million. Unfortunately, research revenue is not expected to continue to grow at recent historical rates. Furthermore, federal budget deficits may pose significant constraints on the federal government's ability to fill this void. Penn must continue to identify new, diversified revenue sources.

Other challenges include ever-increasing competitive pressures, both in the recruitment and retention of faculty, students, and staff. While we will continue to strive to exceed our peers and benchmarks, more modest investment returns are expected. And finally Penn will need to balance the demand for resources between the significant future plans for campus expansion and the continued need for investment in existing assets in the form of facilities renewal.

Importantly, following a national search, the Trustees appointed Dr. Amy Gutmann, Provost and Laurance S. Rockefeller University Professor of Politics and the University Center for Human Values at Princeton University, to become our eighth President effective July 1, 2004. Dr. Gutmann succeeds Dr. Judith Rodin, who stepped down June 30, 2004, following ten successful years as Penn's president. Dr. Gutmann is a renowned scholar in political philosophy and democratic theory. She brings a wealth of expertise and enthusiasm to the Penn presidency.

In her inaugural address in October 2004, Dr. Gutmann outlined her priorities through the principles of the Penn Compact. They are:
(1) increasing access to a Penn education,
(2) fostering integrated knowledge and (3) engaging both locally and globally. Developing creative ways to fund this Compact will be an exciting challenge for us. Through this initiative, Dr. Gutmann's goal is to keep Penn on its positive momentum and move Penn "from excellence to eminence". We are delighted by this pursuit and know it is attainable.

In ending this year's message, I wish to personally acknowledge Dr. Rodin for her extraordinary vision, energy and accomplishments as she led the University for the past ten years. Dr. Rodin often used the word "extraordinary" to describe many facets of Penn. This is the word that most aptly describes her vision and contributions to her alma mater. She served as a role model to faculty, student and staff with her energy and achievements and leaves the University a significantly stronger institution than when she arrived.

Craig R. Carnaroli

Craig R. Carnaroli
Senior Vice President for Finance and Treasurer


Ben statue on College Green, 2003

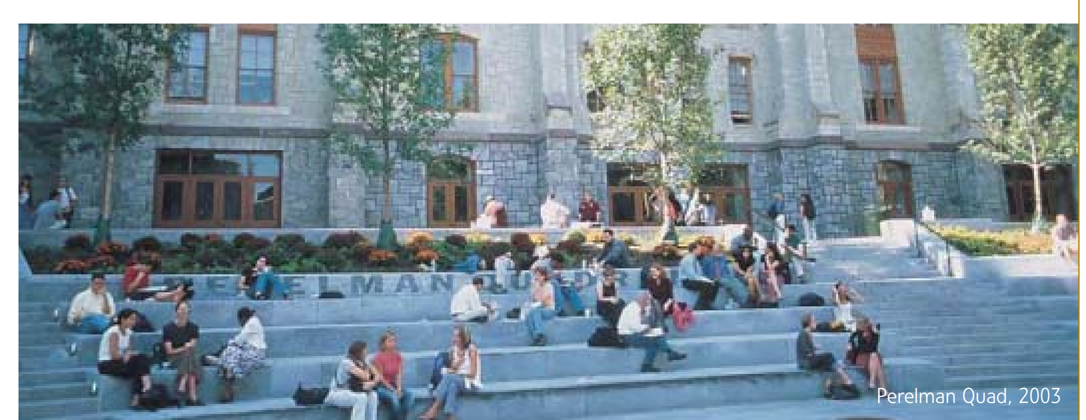
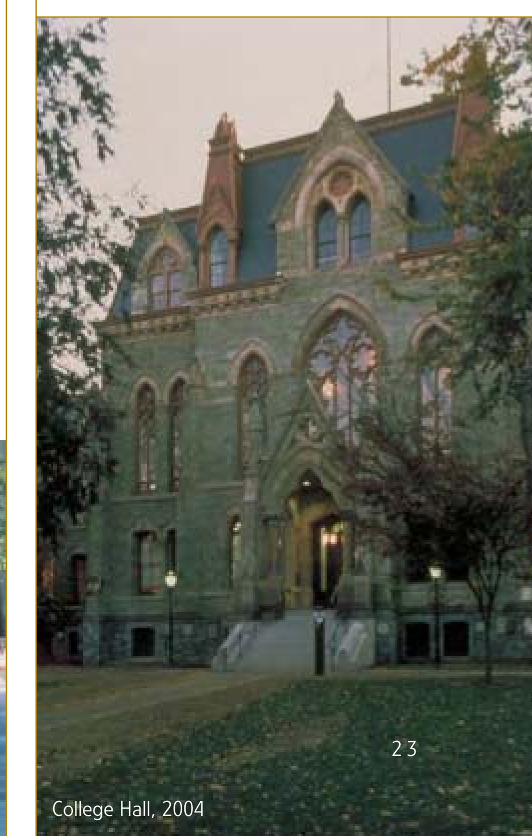

Perelman Quad, 2003


Photo by Stuart Watson
Amy Gutmann Inauguration Ceremony, 2004


Entrance gate to Smith Walk, 2003


College Hall, 2004

Aerial view of city from Penn's campus, 2003

financial information

a five-year review of investments
(thousands of dollars)

	2004	2003	2002	2001	2000
Investments:*					
Fair Value					
Stocks	$1,932,096	$1,548,636	$1,689,648	$1,902,998	$1,695,205
Bonds	1,114,490	1,196,693	1,183,923	915,088	1,321,508
Short-term	367,685	354,914	303,812	343,810	348,561
Real Estate	131,087	133,367	171,924	120,128	157,487
Absolute value	594,323	498,394	334,691	245,634	137,829
Private equity	118,154	81,875	64,882	65,410	34,666
Other	4,757	6,432	12,479	39,222	24,350
Total Investments	$4,262,592	$3,820,311	$3,761,359	$3,632,289	$3,719,606
Endowment:					
Fair Value	$4,018,660	$3,547,473	$3,393,297	$3,381,848	$3,200,712
Associated Investments Fund:					
Fair Value	$3,356,467	$2,859,041	$2,772,040	$2,800,390	$2,556,597

* Excludes securities held as collateral under a securities lending program.

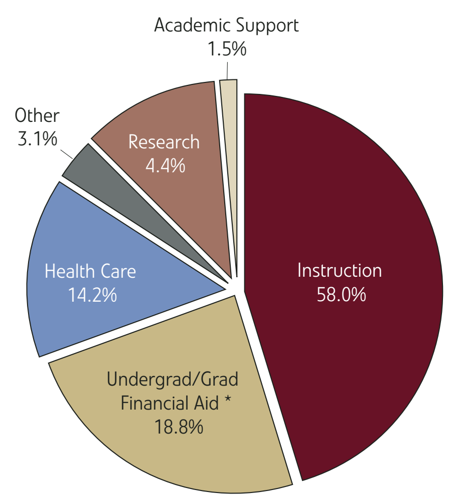
endowment

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. At June 30, 2004, the endowment had a market value of $4.019 billion and funded 3.8% of the University's consolidated operating budget during the fiscal year. Penn's total endowment includes individual endowments from all of Penn's schools and centers, which serve a variety of purposes as shown in the chart below.

Over the fiscal year, the market value of the endowment increased by $471 million. The increase to endowment included realized and unrealized gains from investments of $394 million and net gifts and transfers of $140 million. Reductions to endowment came from spending rule liquidation of $63 million.

Endowment By Purpose

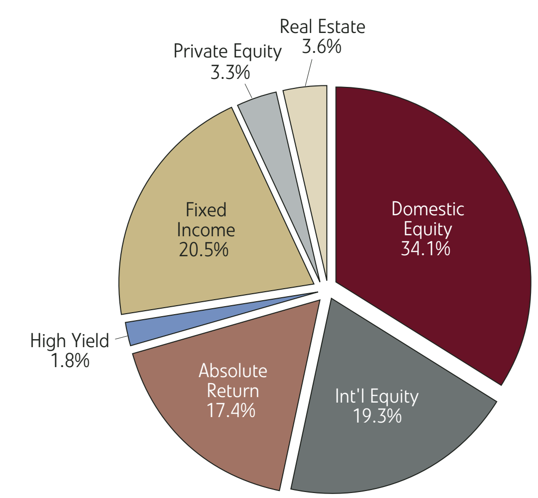


** Includes graduate stipends.*

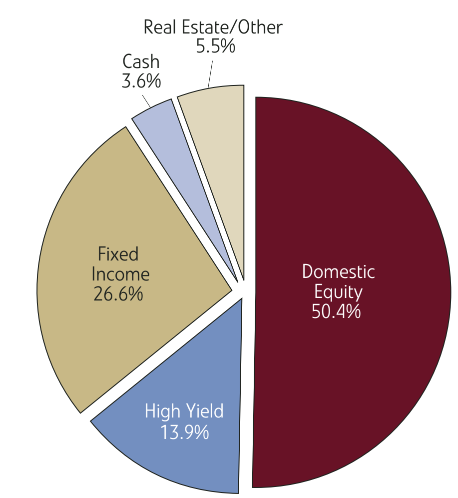
associated investments fund

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 $3.356 billion as of June 30, 2004. The A.I.F. is managed 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. This shift in asset allocation is illustrated below.

AIF Asset Allocation 6/30/04



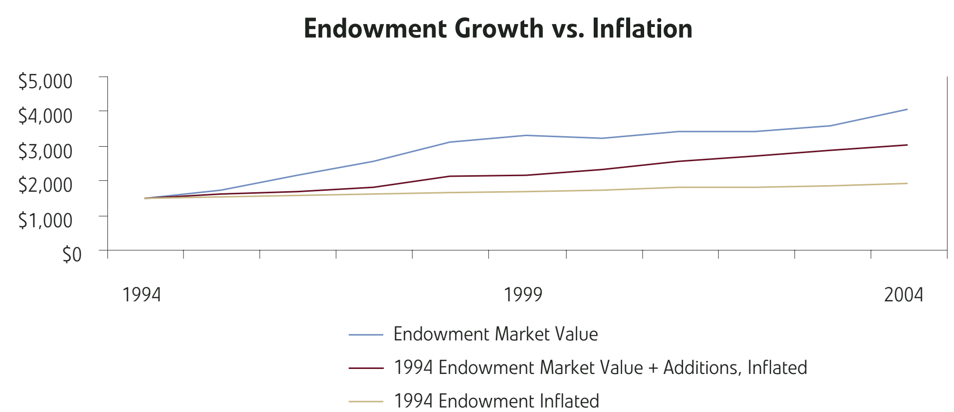
AIF Asset Allocation 6/30/94



For fiscal 2004 the endowment generated an investment return of 16.8%, out-performing its composite benchmark by 2.5%. 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 14.4% over the same period.

Compared to its peers, defined as other endowments with over $1 billion in assets, Penn's performance in fiscal 2004 is at the median return of 16.8%.

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 and gifts reduced by spending contributed to the University. The red line shows the growth in endowment including gifts reduced by spending, 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 both gifts and inflation over this time period.



Investment performance over longer periods, compared to relevant benchmarks, is shown in the chart below.

Total Return Performance Comparison
Periods Ended June 30, 2004
Annualized Returns (%)

Category	10 Years	5 Years	3 Years	1 Year
Associated Investments Fund (A.I.F.)	10.4	4.9	6.9	16.8
Composite Index *	9.8	1.4	3.4	14.3
DJ Wilshire 5000	11.5	-1.0	0.8	21.2
Lehman Bros. Gov't./Credit Index	7.4	7.1	6.7	-0.7

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

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 2004 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 2004 the total amount distributed under the spending policy was $131.5 million of which $26 million was allocated for the common expenses (e.g., heat, light, maintenance) of the schools and centers benefiting from the endowment. Over the past decade, unitized spending has grown by 4.1% annually, 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 31 to 50, 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 30.

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 auditors and meeting with management, internal auditors, and the independent auditors to ensure that each is carrying out their responsibilities. Both internal auditors and the independent auditors have full and free access to the Committee on Audit and Compliance.

Judith Rodin
President

Craig R. Carnaroli
Senior Vice President for Finance
and Treasurer

Kenneth B. Campbell
Comptroller

report of independent auditors

To the Trustees of the
University of Pennsylvania

In our opinion, the accompanying statement of financial position and the related statements of activities and changes in net assets, cash flows, and expenses by function present fairly, in all material respects, the financial position of University of Pennsylvania at June 30, 2004, 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 the University of Pennsylvania's 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 2003 financial statements, and in our report dated September 29, 2003, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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.

[redacted]

September 10, 2004

statement of financial position

(thousands of dollars)

	June 30, 2004	June 30, 2003
Assets		
Cash and cash equivalents	$ 532,388	$ 392,825
Accounts receivable, net of allowances of $12,780 and $10,162	127,919	151,458
Patient receivables, net of allowances of $96,511 and $85,211	378,396	350,676
Contributions receivable, net	220,779	215,923
Loans receivable, net of allowances of $3,466 and $4,097	97,595	100,399
Other assets	105,660	118,190
Assets held for sale	44,921	-
Investments, at fair value	4,409,792	4,088,997
Plant, net of depreciation	2,716,663	2,697,951
Total assets	$ 8,634,113	$ 8,116,419
Liabilities		
Accounts payable	$ 93,039	$ 107,489
Accrued expenses and other liabilities	664,112	581,895
Collateral due broker	147,200	268,686
Liabilities associated with assets held for sale	6,686	-
Deferred income	69,648	60,369
Deposits, advances, and agency funds	119,447	108,420
Federal student loan advances	78,712	78,384
Accrued retirement benefits	215,032	205,606
Debt obligations	1,352,517	1,377,092
Total liabilities	2,746,393	2,787,941
Net assets		
Unrestricted	2,871,551	2,684,286
Temporarily restricted	1,422,228	1,164,424
Permanently restricted	1,593,941	1,479,768
	5,887,720	5,328,478
Total liabilities and net assets	$ 8,634,113	$ 8,116,419

The accompanying notes are an integral part of these financial statements.

statement of activities

(thousands of dollars)

for the year ended June 30, 2004
(with summarized financial information for the year ended June 30, 2003)

	Unrestricted	Restricted: Temporarily	Restricted: Permanently	2004	2003
Revenue and other support:					
Tuition and fees, net	$ 518,992			$ 518,992	$ 487,883
Commonwealth appropriations	42,946			42,946	44,302
Sponsored programs	678,724			678,724	646,674
Contributions	40,670	$ 47,946		88,616	101,344
Investment income	81,994	83,753		165,747	179,237
Hospitals and physician practices	1,949,818			1,949,818	1,778,797
Sales and services of auxiliary enterprises	91,187			91,187	86,247
Other income	132,534			132,534	123,316
Independent operations	54,780			54,780	52,482
Net assets released from restrictions	133,163	(133,163)			
	3,724,808	(1,464)		3,723,344	3,500,282
Expenses:					
Program:					
Instruction	721,299			721,299	678,916
Research	549,404			549,404	531,263
Hospitals and physician practices	1,908,452			1,908,452	1,752,341
Auxiliary enterprises	104,926			104,926	98,872
Other educational activities	118,737			118,737	108,254
Student services	37,831			37,831	37,264
Support:					
Academic support	56,657			56,657	51,192
Management and general	162,741			162,741	162,512
Independent operations	56,098			56,098	51,302
	3,716,145			3,716,145	3,471,916
Increase (decrease) in net assets before nonoperating revenue, net gains, reclassifications and other	8,663	(1,464)		7,199	28,366
Nonoperating revenue, net gains, reclassifications and other:					
Gain on investment, net	123,971	291,421	$ 21,696	437,088	55,218
Investment income, net of amounts classified as operating revenue	(18,350)	(37,346)	937	(54,759)	(54,030)
Contributions	20,779	52,240	91,540	164,559	146,616
Additional minimum pension liability	2,441			2,441	(4,966)
Income from discontinued operations	2,714			2,714	1,003
Net assets released from restrictions	47,047	(47,047)			
Increase in net assets	187,265	257,804	114,173	559,242	172,207
Net assets, beginning of year	2,684,286	1,164,424	1,479,768	5,328,478	5,156,271
Net assets, end of year	$2,871,551	$1,422,228	$1,593,941	$5,887,720	$5,328,478

The accompanying notes are an integral part of these financial statements.

statement of cash flows

(thousands of dollars)

for the years ended June 30, 2004 and 2003

	2004	2003
Cash flows from operating activities:		
Increase in net assets	$ 559,242	$ 172,207
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	202,670	199,029
Provision for bad debts	135,543	118,013
Gain on investments, net	(437,088)	(55,218)
Loss on disposal of plant, property and equipment	2,619	1,042
Nonoperating income designated for the acquisition of long-lived assets and long-term investment	(109,800)	(92,586)
Additional minimum pension liability	(2,441)	4,966
Changes in operating assets and liabilities:		
Patient, accounts and loans receivable	(127,967)	(141,054)
Contributions receivable	5,356	(695)
Other assets	12,001	(10,289)
Accounts payable, accrued expenses and accrued retirement benefits	67,809	99,832
Deposits, advances and agency funds	10,887	17,629
Deferred income	9,279	10,450
Net cash provided by operating activities	328,110	323,326
Cash flows from investing activities:		
Student loans repaid	20,003	21,929
Student loans issued	(20,518)	(17,511)
Purchase of investments	(5,045,240)	(5,752,207)
Proceeds from sale of investments	5,033,465	5,754,273
Purchase of plant, property and equipment	(250,055)	(274,510)
Net cash used by investing activities	(262,345)	(268,026)
Cash flows from financing activities:		
Proceeds from contributions received designated for the acquisition of long-lived assets and long-term investment	102,868	101,336
Federal student loan advances	328	(625)
Repayment of long-term debt	(184,186)	(57,865)
Issuance of long-term debt	154,788	-
Net cash provided by financing activities	73,798	42,846
Net increase in cash and cash equivalents	139,563	98,146
Cash and cash equivalents, beginning of year	392,825	294,679
Cash and cash equivalents, end of year	$ 532,388	$ 392,825
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 54,945	$ 55,409
Non-cash activity		
Due from First Hospital Foundation	$ 607	$ 838

The accompanying notes are an integral part of these 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 (UPHS). The University is a tax-exempt organization under Section 501(c) (3) of the Internal Revenue Code.

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, 2003 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, 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 for restricted investments which 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 income investments with a maturity of less than one year when purchased 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. For the fiscal year ended June 30, 2004, the University's principal derivative financial instruments are forward currency contracts. For the fiscal year ended June 30, 2003, the University's principal derivative financial instruments were forward mortgage contracts. Fair values for certain hedge funds, 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. Investments in entities which are not consolidated are reported in Other assets principally using the equity method.

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 in equities, bonds, hedge funds, private equity and real estate limited partnerships. 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. For the fiscal years ended June 30, 2004 and June 30, 2003, the spending policy for the A.I.F. was 4.7% of the three year average market value lagged one year.

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. Upon disposal of assets, the cost and related accumulated depreciation are removed from the accounts and the resulting net gain or loss is included in total expenses. Rare books and other collectibles are not depreciated.

Effective July 1, 2002, the University adopted SFAS No. 143 "Accounting for Asset Retirement Obligations." SFAS No. 143 requires the University to recognize the fair value of legal liabilities associated with the retirement of long-lived assets in the period in which the obligations are incurred. A corresponding amount is capitalized as part of the book value of the long-lived asset. The University has determined that it does not have a material obligation associated with the retirement of long-lived assets as described by this statement.

Intangible Assets

Intangible assets are included in Other assets in the accompanying Statement of Financial Position. Goodwill of $34,843,000 at June 30, 2004 and $36,502,000 at June 30, 2003 associated with the statutory merger of the Presbyterian Medical Center of Philadelphia into UPHS 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 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.

Tuition and Fees

The University maintains a policy of offering qualified undergraduate 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 grants and scholarships in the amount of $134,355,000 in 2004 and $123,469,000 in 2003.

Sponsored Programs

The University receives grant and contract revenue from governmental and private sources. In 2004 and 2003, grant and contract revenue earned from governmental sources totaled $579,114,000 and $548,329,000, 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 generally 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 donate, are recognized as revenue in the period received. 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 donate and contributions of cash and other assets designated for the acquisition of long-lived assets and long-term investment are reported with nonoperating revenue, net gains, reclassifications and other.

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.

Hospital and physician practices

Hospital and physician practices revenue is derived primarily from UPHS patient services and is accounted for at established rates on the accrual basis in the period the service is provided. Patient service revenue is net of charity care and community service. Certain revenue received from third-party payers is subject to audit and retroactive adjustment. Additionally, UPHS 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

Summarized financial information

In 2002, the Trustees of the University of Pennsylvania formed Penn Medicine, the governance structure which oversees the activities of UPHS and the University of Pennsylvania School of Medicine. The governing body operates, oversees and coordinates the academic, research and clinical missions of Penn Medicine. Penn Medicine replaced the prior multiple governing boards of UPHS and the School of Medicine, all of which were dissolved, with this single governing board.

UPHS is comprised of the Clinical Practices of the University of Pennsylvania, Clinical Care Associates, Hospital of the University of Pennsylvania, Presbyterian Medical Center of the University of Pennsylvania Health System, Phoenixville Hospital of the University of Pennsylvania Health System, Pennsylvania Hospital of the University of Pennsylvania Health System and Wissahickon Hospice of the University of Pennsylvania Health System. In addition, the activities of UPHS'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.

Throughout the year, certain transactions are conducted between UPHS and the University. The effect of these transactions (primarily billings for allocations of common costs, physicians' salaries and benefits, certain purchased services and support for the School of Medicine) is included in the summarized financial information of UPHS. At June 30, 2004 and 2003, UPHS's net liability to the University was $6,782,000 and $7,792,000, respectively, which represents normal current inter-entity activity and is eliminated in the consolidated financial statements.

UPHS transferred to the School of Medicine from its operations $29,673,000 and $37,006,000 in 2004 and 2003, respectively, to further research and educational activities. These activities are integral to the overall mission of Penn Medicine and the effect of the transfers is reflected in UPHS, nonoperating, net. This transaction is eliminated in the consolidated financial statements.

Final adjustments to revenue, resulting from settlements with third-party payers, are recorded in the year in which they are settled. Third party settlements resulted in an increase in net patient revenue of $11,765,000 in 2004 and a decrease to net patient revenue of $6,824,000 in 2003.

In 2002, UPHS 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 original repayment terms set to begin in December 2002 for certain IBC advances. The advances due IBC are reflected as liabilities, at their discounted value.

Payments made to 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 most procedural based services and high intensity medical cases (over 60% of all inpatient admissions in all) and on a per diem basis for all other services. The inpatient rates also provide for annual inflationary increases. Payment for outpatient services rendered to IBC traditional subscribers are principally based upon a percentage of billed charges.

Summarized financial information for UPHS as of June 30, 2004 and 2003, prior to eliminations for transactions between UPHS and other entities of the University, is as follows (in thousands):

	2004	2003
Net patient service	$ 1,863,694	$ 1,693,682
Other revenue	114,484	115,213
Total expenses	(1,922,751)	(1,767,564)
Excess of revenues over expenses from operations	55,427	41,331
Other unrestricted income, net	2,266	4,782
Excess of revenue over expenses	57,693	46,113
Nonoperating, net	27,017	(34,995)
Increase in net assets	$ 84,710	$ 11,118
Total current assets	$ 588,053	$ 540,021
Assets whose use is limited (including board designated funds of $293,966 and $283,704 and trustee held funds of $19,576 and $21,087 for 2004 and 2003, respectively)	750,286	675,033
Plant, net of depreciation	588,315	624,369
Investments and other assets	51,149	63,517
Total assets	$ 1,977,803	$ 1,902,940
Total current liabilities	$ 346,571	$ 353,548
Long-term debt, net of current portion	750,377	775,027
Other liabilities	299,292	277,512
Total liabilities	1,396,240	1,406,087
Net assets		
Unrestricted	194,008	162,276
Temporarily restricted	270,880	237,286
Permanently restricted	116,675	97,291
Total net assets	581,563	496,853
Total liabilities and net assets	$ 1,977,803	$ 1,902,940

During June 2004, UPHS entered into an agreement to sell the assets and certain liabilities of Phoenixville Hospital of the University of Pennsylvania Health System (Phoenixville Hospital) for $100,800,000. Assets transferred as part of the sale include certain prepayments and inventory, and property and equipment. Liabilities include accounts payable and compensated absences. Income from operations for Phoenixville Hospital for the years ended June 30, 2004 and 2003, was $2,714,000 and $1,003,000, respectively, and is included in Income from discontinued operations in the accompanying Statement of Activities. Phoenixville Hospital had net revenues of $102,535,000 and $90,033,000 for the years ended June 30, 2004 and 2003, respectively.

The sale was completed on August 1, 2004, resulting in a gain of approximately $31,800,000. Additionally, long-term debt and capital leases of $34,000,000 were retired as a result of this transaction.

3. Investments

A summary of investments, stated at fair value, at June 30, 2004 and 2003 is as follows (in thousands):

	2004	2003
Investment sales receivable	$ 8,001	$ 49,010
Short-term	514,885	593,185
Stocks	1,925,601	1,546,916
Bonds	1,113,067	1,179,819
Real estate	131,087	133,367
Absolute return	594,323	498,394
Private equity	118,154	81,875
Other	4,674	6,431
End of year	$ 4,409,792	$ 4,088,997
Beginning of year	$ 4,088,997	$ 4,327,504

Included in investments are assets held in trust for the University with an aggregate fair value of $309,172,000 at June 30, 2004 and $274,421,000 at June 30, 2003.

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, 2004 and 2003, short-term investments held under this arrangement aggregated $2,829,000 and $4,486,000, respectively.

At June 30, 2004 and 2003, investments with a fair value of $31,871,000 and $36,660,000, respectively, were held by trustees under indenture and escrow agreements.

Included in investments is $755,000 and $930,000 of cash that is held in escrow at June 30, 2004 and 2003, respectively.

At June 30, 2004 and 2003, investments with a fair value of $143,454,000 and $261,637,000, 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 and U.S. Treasury obligations. Cash deposits included in Short-term investments are $147,200,000 and $238,271,000 at June 30, 2004 and 2003, respectively. U.S. Treasury obligations included in Bonds are $0 and $30,415,000 at June 30, 2004 and 2003, respectively. The University is indemnified against borrower default by the financial institution that is acting as its lending agent.

At June 30, 2004 and 2003, short-term investment securities with a fair value of $2,507,000 and $159,154,000, respectively, have been earmarked for the purchase of other long-term investments.

The University is obligated under certain limited partnership investment fund agreements to advance additional funding periodically up to specified levels. At June 30, 2004, the University had unfunded commitments of $288,514,000, which are estimated to be drawn through 2010.

A summary of the University's total investment return for the years ended June 30, 2004 and 2003 as reported in the Statement of Activities is presented below (in thousands):

	2004	2003
A.I.F. investment income	$ 71,527	$ 77,804
A.I.F. realized and unrealized gains and (losses)	418,023	57,438
Return on A.I.F.	489,550	135,242
Other investment income, gains and losses	58,526	45,183
Total return on investments	$ 548,076	$ 180,425

Income distributed for operations under the A.I.F. spending rule exceeded available income, net of expenses and net of income permanently reinvested, by $68,355,000 in 2004 and by $69,109,000 in 2003.

4. Accounts Receivable

The major components of receivables, net of reserve for doubtful accounts of $12,780,000 and $10,162,000 at June 30, 2004 and 2003, respectively, are as follows (in thousands):

	2004	2003
Sponsored research	$ 55,176	$ 65,200
Student	16,916	20,471
Trade	21,383	19,636
Investment income	4,190	9,620
Other	30,254	36,531
Total Receivables	$ 127,919	$ 151,458

5. Contributions Receivable

A summary of contributions receivable is as follows at June 30, 2004 and 2003 (in thousands):

	2004	2003
Unconditional promises expected to be collected in:		
Less than one year	$ 121,064	$ 51,666
One year to five years	148,470	223,112
Over five years	12,031	7,213
	281,565	281,991
Less: Discount and allowance for doubtful amounts	(60,786)	(66,068)
Contributions receivable, net	$ 220,779	$ 215,923

6. Other Assets

The major components of Other assets at June 30, 2004 and 2003, respectively, are as follows (in thousands):

	2004	2003
Goodwill	$ 34,843	$ 36,502
Defined benefit pension asset	20,283	32,527
Inventory	19,294	18,530
Prepaid expenses	16,649	14,331
Deferred financing fees	6,727	7,242
Other	7,864	9,058
	$ 105,660	$ 118,190

7. Plant, net of depreciation

The components of plant at June 30, 2004 and 2003 are as follows (in thousands):

	2004	2003
Land	$ 91,515	$ 95,720
Buildings	3,131,101	3,036,569
Contents	1,487,779	1,489,270
Construction-in-progress	137,134	110,750
	4,847,529	4,732,309
Less: accumulated depreciation	(2,130,866)	(2,034,358)
Plant, net of depreciation	$ 2,716,663	$ 2,697,951

The University recorded $196,367,000 and $190,975,000 of depreciation expense for the years ended June 30, 2004 and 2003, respectively. Rare books and other collectibles aggregating $20,470,000 at June 30, 2004 and $19,712,000 at June 30, 2003 are not subject to depreciation.

8. Split-Interest Agreements

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

	2004	2003
Charitable gift annuities	$ 23,052	$ 22,257
Charitable remainder trusts	23,295	20,807
Pooled income funds	1,445	886
Total split-interest agreements	$ 47,792	$ 43,950

9. Debt Obligations

Debt obligations at June 30, 2004 and 2003 are as follows (in thousands):

	Maturity	Interest Rate at June 30, 2004	June 30, 2004	June 30, 2003
Academic Component:				
Fixed Rate Debt Obligations:				
Pennsylvania Higher Education				
Facility Authority (PHEFA)				
Series A of 1995 Revenue Bonds	09/2015	5.3% - 7.0%	$ 83,320	$ 87,950
Series B of 1995 Revenue Bonds	09/2015	5.3% - 7.0%	37,495	39,575
Series of 1998 Revenue Bonds	07/2038	4.5% - 5.5%	190,620	192,670
Unamortized Discount			(1,862)	(1,943)
Series A of 2002 Revenue Bonds	07/2008	3.0% - 5.0%	14,590	16,825
Unamortized Premium			346	537
Department of Education Bonds	03/2007	3.0%	190	253
Other Loans	Various	3.0% - 8.0%	13,439	11,131
Mortgage Notes	Various	8.0%	7,523	7,777
Total Fixed Rate Debt Obligations			345,661	354,775
Variable Rate Debt Obligations:				
PHEFA				
Series of 1985 Revenue Bonds	12/2015	1.1%	10,610	10,610
Series of 1990 Revenue Bonds	12/2020	1.1%	6,500	6,500
Series B of 2002 Revenue Bonds	07/2032	1.1%	49,625	50,300
Quakertown General Authority				
Pool Financing			-	71,745
Washington County Authority				
Lease Revenue Bonds			-	55,252
Quakertown General Authority				
Series of 2004	07/2034	1.0%	77,700	-
Washington County Authority				
Series of 2004	07/2034	1.1%	62,500	-
Other Loans	Various	1.5% - 1.7%	16,393	16,567
Total Variable Rate Debt Obligations			223,328	210,974
Total Academic Component Debt Obligations			568,989	565,749
UPHS:				
Fixed Rate Debt Obligations:				
PHEFA				
Series A of 1994 Revenue Bonds	01/2010	5.6% - 7.0%	28,120	31,660
Unamortized Premium			393	465
Series A and B of 1996 Revenue Bonds	01/2022	5.0% - 6.0%	361,295	376,125
Unamortized Discount			(2,198)	(2,300)
Series A of 1998 Revenue Bonds	01/2015	4.4% - 5.4%	38,750	38,750
Unamortized Premium			559	610
Series of 2002 Revenue Bonds	01/2024	7.5%	25,515	26,065
Notes Payable	10/2005	7.0%	7,861	11,408
Capital Leases	Various	4.6% - 5.9%	22,387	26,949
Total Fixed Rate Debt Obligations			$ 482,682	$ 509,732

	Maturity	Interest Rate at June 30, 2004	June 30, 2004	June 30, 2003
Variable Rate Debt Obligations:				
PHEFA				
Series B of 1994 Revenue Bonds	06/2024	1.1%	$ 90,000	$ 90,000
Series C of 1996 Revenue Bonds	01/2026	1.1%	80,000	80,000
Series B of 1998 Revenue Bonds	01/2026	1.1%	121,600	121,600
Pennsylvania Economic Development				
Financing Authority Series C of 1994				
Revenue Bonds	09/2015	1.3%	8,583	9,083
Mortgage Notes	01/2007	1.5%	663	928
Total Variable Rate Debt Obligations			300,846	301,611
Total UPHS Debt Obligations			783,528	811,343
Total University Debt Obligations			$ 1,352,517	$ 1,377,092

The fair value of the University's debt obligations was $1,371,917,000 and $1,458,584,000 at June 30, 2004 and 2003, respectively. The fair value represents the quoted market value for PHEFA Revenue Bonds and Department of Education 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
2005	$ 51,420
2006	46,139
2007	46,213
2008	49,212
2009	52,481

Academic Component

The University borrowed an additional $8,633,000 under its leases from the Washington County Authority Lease Revenue Bonds (Higher Education Pooled Equipment Leasing Program), Series 1985-A for University facilities on April 6, 2004. On May 27, 2004, the Washington County Authority issued Refunding Revenue Bonds, Series of 2004 ("Washington County Series 2004 Bonds"), with an aggregate principal amount of $62,500,000. The proceeds were used to refund the University's leases from the Series 1985-A Bonds, including both the 2004 and prior lease borrowings. Interest on the Washington County Series 2004 Bonds is reset weekly through a remarketing process. The Series 2004 bonds are subject to redemption to meet mandatory sinking fund requirements in amounts ranging from $500,000 in 2008 to $4,500,000 in 2034. The bonds are callable upon seven days' notice at a price equal to 100% of the principal amount plus accrued interest. Additionally, the bonds may be put by investors upon seven days' notice. The University is directly obligated to fund tendered bonds which cannot be remarketed.

On June 3, 2004, the University borrowed $5,955,000 of additional loans from the Quakertown General Authority pooled financing program for capital projects. On June 24, 2004, the Quakertown General Authority issued Refunding Revenue Bonds, Series 2004 ("Quakertown Series 2004 Bonds"), with an aggregate principal amount of $77,700,000. The proceeds were used to refund the University's loans from the Quakertown General Authority pooled financing program bonds. The Quakertown Series 2004 bonds are insured by AMBAC Assurance Corporation. Interest on the Series 2004 Bonds is reset weekly through an auction process. The Bonds are subject to redemption to meet mandatory sinking fund requirements in amounts ranging from $500,000 in 2008 to $5,675,000 in 2034. The bonds are callable upon seven days' notice at a price equal to 100% of the principal amount plus accrued interest.

On August 1, 2002, the $20,240,000 Pennsylvania Economic Development Financing Authority Revenue Bonds, Series 2001A dated August 1, 2001, were retired, as the pre K-8 school in University City constructed with these bond proceeds was sold to the School District of Philadelphia. These bonds had been issued August 1, 2001 and their proceeds loaned pursuant to a Loan Agreement dated August 1, 2001, to University City Associates, Inc. (UCA), a wholly-owned subsidiary of the University. UCA used the bond proceeds for the construction of the pre K-8 University-assisted public school in the West Philadelphia area, referenced above.

UPHS

The PHEFA Revenue Bonds, exclusive of Series of 2002, were issued under UPHS's Master Trust Indenture (MTI). The MTI and related agreements contain certain restrictive covenants which limit the issuance of additional indebtedness, and among other things, require UPHS 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. If the coverage requirement for a particular year is not met, within six months of the close of that fiscal year UPHS must retain the services of a consultant to make recommendations to improve the coverage requirement. UPHS must also implement the recommendations of the consultant to the extent that they can be feasibly implemented. UPHS will not be considered to be in default of the provisions of the MTI so long as it has sufficient cash flow to pay total operating expenses and to pay debt service for the fiscal year. In both 2004 and 2003, UPHS met its debt service coverage requirement under the MTI.

Subsequent to June 30, 2004, in connection with the sale of Phoenixville Hospital, Pennsylvania Hospital assumed responsibility for the Series of 2002 Bonds and UPHS retired an identical amount of PHEFA Series 1998B Bonds.

10. Natural Classification of Expenditures

Expenses incurred were for (in thousands):

	Compensation	Student Aid	Depreciation	Interest	Other Operating	Total
June 30, 2004						
Instruction	$ 456,766	$ 42,758	$ 31,501	$ 2,448	$ 187,826	$ 721,299
Research	308,445	8,568	27,281	8,588	196,522	549,404
Hospitals and physician practices	1,007,648		85,058	32,813	782,933	1,908,452
Auxiliary enterprises	21,202		13,288	4,444	65,992	104,926
Other educational activities	79,759	1	5,603	837	32,537	118,737
Student services	22,976	86	–	164	14,605	37,831
Academic support	25,278		21,256	784	9,339	56,657
Management and general	120,551	82	6,946	937	34,225	162,741
Independent operations	4,852		5,434	2,252	43,560	56,098
Total	$ 2,047,477	$ 51,495	$ 196,367	$ 53,267	$ 1,367,539	$ 3,716,145
June 30, 2003	$ 1,903,962	$ 45,580	$ 190,975	$ 57,370	$ 1,274,029	$ 3,471,916

11. Operating Leases

The University leases research labs, office space and equipment under operating leases expiring through November 2024. Rental expense for the years ended June 30, 2004 and 2003 totaling $48,216,000 and $41,594,000, respectively, is included in the accompanying Statement of Activities.

At June 30, 2004, future minimum lease payments under operating leases with remaining terms greater than one year were as follows (in thousands):

2005	$ 37,618
2006	32,498
2007	27,896
2008	23,197
2009	21,218
Thereafter	157,038
Total minimum lease payments	$ 299,465

12. Pension and Other Postretirement Benefit Costs

Retirement benefits are provided for academic employees and certain administrative and support 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 $58,458,000 in 2004 and $52,148,000 in 2003.

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.

Clinical Care Associates has a non-contributory defined contribution retirement plan covering all eligible employees. Clinical Care Associates has also established a non-qualified supplemental retirement plan to provide retirement benefits to a select group of physician employees. Contributions to these plans are based upon the annual compensation of the eligible employees. Retirement plan expense was $3,363,000 and $3,111,000 for 2004 and 2003, respectively.

Obligations and Funded Status

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

	Pension Benefits		Other Postretirement Benefits	
	2004	2003	2004	2003
Change in benefit obligation:				
Benefit obligation at beginning of fiscal year	$ 646,895	$ 486,539	$ 323,682	$ 276,066
Service cost	20,367	14,433	14,464	10,414
Interest cost	37,916	34,581	18,044	18,627
Plan participants' contributions	-	-	889	2,398
Amendments	-	5,058	2,211	-
Actuarial (gain) loss	(38,927)	121,135	27,057	30,363
Benefits paid	(18,996)	(18,649)	(15,479)	(14,186)
Benefit obligation at end of fiscal year	$ 647,255	$ 643,097	$ 370,868	$ 323,682
Change in plan assets:				
Fair value of plan assets at beginning of fiscal year	$ 523,936	$ 518,975	$ 78,831	$ 71,377
Actual return on plan assets	93,651	20,414	12,029	3,854
Employer contribution	3,835	917	19,253	17,047
Plan participants' contributions	101	-	889	738
Benefits paid	(18,996)	(18,649)	(15,479)	(14,185)
Fair value of plan assets at end of fiscal year	$ 602,527	$ 521,657	$ 95,523	$ 78,831
Reconciliation of funded status:				
Funded status	$ (44,728)	$ (121,620)	$ (275,345)	$ (244,851)
Unrecognized net actuarial loss	16,574	107,802	116,890	100,315
Unrecognized prior service cost (benefit)	14,876	16,551	(19,895)	(26,113)
Unrecognized transition asset	-	(268)	-	-
Net amount recognized	$ (13,278)	$ 2,465	$ (178,350)	$ (170,649)

Pension figures for the period ended June 30, 2004 include amounts for Fraternal Order of Police pension plan that were not included at June 30, 2003.

	Pension Benefits 2004	Pension Benefits 2003	Other Postretirement Benefits 2004	Other Postretirement Benefits 2003
Amounts recognized on balance sheet:				
Prepaid pension cost in other assets	$ 20,283	$ 32,527	$ -	$ -
Accrued retirement benefits	(33,561)	(30,062)	(178,350)	(170,649)
	$ (13,278)	$ 2,465	$ (178,350)	$ (170,649)

Accrued retirement benefits includes $3,121,000 and $4,897,000 for faculty early retirement program at June 30, 2004 and 2003, respectively.

notes to financial statements

Certain UPHS plans have an accumulated benefit obligation in excess of plan assets as follows (in thousands):

	2004	2003
Projected benefit obligation	$ 508,907	$ 502,803
Accumulated benefit obligation	$ 435,055	$ 424,142
Fair value of plan assets	$ 448,165	$ 389,114

Net Periodic Cost

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

	Pension Benefits		Other Postretirement Benefits	
	2004	2003	2004	2003
Service cost	$ 20,367	$ 14,433	$ 14,464	$ 10,414
Interest cost	37,916	34,581	18,044	18,627
Expected return on plan assets	(43,201)	(42,701)	(6,176)	(6,089)
Amortization of prior service cost	1,395	1,435	(4,007)	(4,007)
Amortization of transition asset	(427)	(974)		
Amortization of net actuarial gain	3,528	(493)	4,628	2,920
Net periodic cost	$ 19,578	$ 6,281	$ 26,953	$ 21,865

Additional Information

It was determined that an additional minimum pension liability was required to account for an unfunded accumulated benefit obligation (ABO) relating to the Phoenixville Hospital Pension Plan. This was recorded as a nonoperating charge on the Statement of Activities for the years ended June 30, 2004 and 2003 (in thousands):

	2004	2003
(Decrease) increase in minimum liability included as nonoperating income	$ (2,441)	$ 4,966

Assumptions

The weighted average assumptions used in determining benefit obligations are as follows:

	2004	2003
Discount rate	6.25%	6.00%
Salary Increase	3.50 - 4.75%	4.00 - 4.75%

The weighted average assumptions used in determining net periodic cost are as follows:

	2004	2003
Discount Rate	6.00%	7.25%
Salary Increase	3.50 - 4.75%	4.00 - 4.75%
Expected Return on Plan Assets	8.38%	9.25 - 9.50%
Measurement Date	July 1, 2003	July 1, 2002

The expected long-term rate of return of plan assets is management's best estimate of the average investment return expected to be received on the assets invested in the plan over the benefit period. The expected long-term rate of return on plan assets has been established by considering historical and future expected returns of the asset classes invested in by the pension trust, and the allocation strategy currently in place among those classes.

The assumed Health Care Cost Trend Rates used in determining benefit obligations are as follows:

	2004	2003
Initial Trend Rate	11.5%	7.0%
Ultimate Trend Rate	5.0%	5.0%
Fiscal Year End that Ultimate Trend Rate is Reached	2014	2008

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 (in thousands):

	1-Percentage Point Increase	1-Percentage Point Decrease
Effect on total of service and interest cost	$ 5,629	$ (4,488)
Effect on accumulated postretirement benefit obligation	$ 51,155	$ (42,581)

Plan Assets

The principal investment objectives for the pension and other postretirement benefits plans are: to ensure the availability of funds to pay pension benefits as they become due under a broad range of future economic scenarios; to maximize long-term investment returns with an acceptable level of risk based on the pension obligations; and to invest the pension trust in a diversified manner across equity and debt securities. The equity securities are diversified, and comprised predominantly of developed market liquid assets, across a range of investment styles. Domestic equities comprised 47% and international equities comprised 24% of plan assets at June 30, 2004. The average quality of debt securities at June 30, 2004 was AAA with an effective duration of 4.17 years. The target and actual allocation for plan assets is as follows:

	Target	2004	2003
Equity securities	70.0%	71.0%	70.0%
Debt securities	30.0%	29.0%	30.0%
	100.0%	100.0%	100.0%

Cash Flows

The University's expected contributions under the plans for the year ending June 30, 2005 total $20,501,000.

Estimated Future Benefit Payments

The benefit payments to retirees which reflect future service are expected to be paid as follows (in thousands):

	Pension Benefits	Other Postretirement Benefits
For the year ended June 30,		
2005	$ 21,170	$ 15,964
2006	22,094	17,508
2007	23,152	19,063
2008	24,715	20,498
2009	26,608	21,681
2010 and beyond	174,311	133,367

In accordance with FSP 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act 0f 2003", the University has made a one-time election to defer recognition of the effects of the Medicare Part D legislation in the accounting for its plan under FSP 106.

Such recognition will be included in fiscal 2005 expense and disclosure as required by FSP 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003", which supersedes FSP 106-1.

13. Medical Professional Liability Claims

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

Mcare levies health care provider surcharges, as a percentage of the Pennsylvania Joint Underwriters Association rates for basic coverage, to pay claims and pay administrative expenses of Mcare 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 Mcare assessments in the accompanying financial statements as the University's portion of the unfunded Mcare 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 5.0% discount rate at June 30, 2004.

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 actuarially determined exposure for unreported and unasserted medical professional claims that occurred during the period covered by the commercial insurance policy.

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.

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.

14. Contingencies, Guarantees and Commitments

On November 25, 2002, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 requires that upon issuance or modification of a guarantee, after December 31, 2002, the University must recognize a liability for the fair value of the obligation it assumes under that guarantee.

notes to financial statements

The University has guaranteed certain obligations as follows (in thousands):

	June 30, 2004		June 30, 2003	
	Amount Guaranteed	Recognized Liability	Amount Guaranteed	Recognized Liability
Mortgage Loans	$ 32,448	$ –	$ 25,725	$ 225
Student Loans	141,120	11,415	144,357	12,304
Other	8,955	423	9,377	456
	$ 182,523	$ 11,838	$ 179,459	$ 12,985

To encourage home ownership and home improvement in the University's geographic area, certain University and affiliate employee mortgage loans are guaranteed. Upon default by the borrower the University may be required to pay any loss incurred following the lender's foreclosure process or the University may be required to purchase the loan. If the University purchases the loan, it will work with the borrower to make the loan current or it may foreclose and recover a portion of any loan from the sale of the mortgaged property. Of the amount guaranteed, $20,171,000 and $8,640,000 at June 30, 2004 and 2003, respectively, was estimated to be recoverable from subsequent sale of underlying assets the University would acquire if it performed under the guarantees. The University does not anticipate that any significant net payments will result from these guarantees. Beginning in fiscal year 2004, FIN 45 does not require a liability to be recognized for guarantees of employee mortgages. The recognized liability at June 30, 2003 reflects the fair value of guarantees issued after December 31, 2002.

The University offers various loan programs for students and families to pay tuition, fees and other costs. Certain loans issued by private lending institutions are guaranteed by the University. Upon default by the borrower, the University is required to pay all or a portion of the outstanding loan balance. Of the amount guaranteed, $30,165,000 and $26,959,000 at June 30, 2004 and 2003, respectively, was estimated to be recoverable from subsequent collection efforts on loans the University would acquire if it performed under the guarantees. A liability is recognized for the estimated net payments that will result from the portfolio of guaranteed loans. The amount of the liability recognized for defaults in the portfolio of guaranteed loans exceeds the estimated fair value of the guarantee that is required to be recognized by FIN 45.

The Other category principally includes guarantees of indebtedness for certain businesses in the University's geographic area whose activities benefit employees, students and the community. The University does not anticipate that any significant net payments will result from these guarantees. Of the amount guaranteed, $5,194,000 at June 30, 2004 and $5,303,000 at June 30, 2003, was estimated to be recoverable from subsequent sale of underlying assets the University would acquire if it performed under the guarantees and from other partners in the business. The recognized liability reflects the fair value of guarantees issued after December 31, 2002.

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 projects that have resulted in capital and property acquisition commitments from the University. As of June 30, 2004, approximately $154,787,000 has been committed by the University.

trustees

as of June 30, 2004

statutory officers

as of June 30, 2004

President
Dr. Judith Rodin

Provost
Dr. Robert L. Barchi

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

Senior Vice President for Facilities and Real Estate Services
Omar H. Blaik

Senior Vice President for Finance and Treasurer
Craig R. Carnaroli

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

Vice President for Communications
Lori N. Doyle

Vice President for Development and Alumni Relations, Interim
Medha Narvekar

Vice President for Government, Community and Public Affairs
Carol R. Scheman

Vice President for Information Systems and Computing
Robin H. Beck

Vice President for Human Resources
John J. Heuer, Ed.D.

Vice President for Business Services
Leroy D. Nunery II, Ed.D.

Vice President for Public Safety
Maureen Rush

Vice President for Audit and Compliance
Rick N. Whitfield, Ed.D.

Secretary of the University
Leslie Laird Kruhly

Comptroller
Kenneth B. Campbell