04 05

FINANCIAL REPORT

Increasing Access

Integrating Knowledge

Engaging Locally and Globally

Student Enrollment [1]
Undergraduate students 10,979
Graduate and professional students 10,103

Undergraduate Admissions Statistics
Applications 18,824
Percent accepted 20.8%
Percent matriculated 65.2%
Average SAT scores 1417

Faculty
Standing faculty 2,471
Associated faculty 2,132

Financial Summary
Total operating revenue $4,046,208
Total operating expenditures $3,969,240

Principal Sources of Revenue
Tuition and fees (net) $552,933
Sponsored programs $732,607
Hospitals and physician practices [2] $2,137,164
Contributions $342,804
Investment income [3] $373,120

Principal Purposes of Expenditures
Instruction $767,353
Research $579,417
Hospitals and physician practices [2] $2,077,749

Endowment
Market value $4,369,782
One-year endowment performance 8.5%

Net Assets
Unrestricted $3,086,908
Temporarily restricted $1,552,907
Permanently restricted $1,748,100

At-a-glance

FY 05 Financial Report

dollars in thousands

(1) Note that full-time equivalent enrollment is calculated based on the number of full-time students plus ⅓ of the headcount for part-time students. Student, admission and faculty statistics are for academic year beginning September 2005, while financial statistics are for fiscal year ending June 30, 2005.

(2) Includes inter-entity eliminations

(3) Includes gains and losses on investments

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Penn Compact

Dr. Amy Gutmann took the helm as Penn's eighth president on July 1, 2004. In her inaugural address, she launched the Penn Compact, her vision for making Penn both a global leader in teaching, research and professional practice, as well as a dynamic agent of social, economic and civic progress. The Compact's focus on increasing access, integrating knowledge and engaging locally and globally already has made Penn a more powerful transformational force throughout the region and nation and around the globe.

Increasing Access

"We must make an excellent Penn education available to all outstanding students of talent and high potential who can benefit from and contribute to our University. In a democracy and at great universities, diversity and excellence go together. To keep them together, we must significantly boost scholarship aid to make Penn even more affordable to exceptional students from all backgrounds."

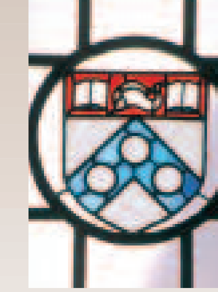
Integrating Knowledge

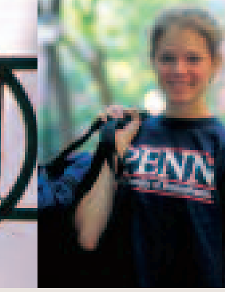
"The most challenging questions and problems of our time cannot be addressed by one discipline or profession. To comprehend our complex world, we must better integrate knowledge from different disciplines and professional perspectives in our research and teaching. Beginning with the recruitment of eminent scholars who will hold joint appointments in two schools and departments, Penn will achieve a truly successful partnership between arts and sciences and our professional schools that will benefit our students, our society, and our world."

Engaging Locally and Globally

"Through our collaborative engagement with communities all over the world, Penn is poised to advance the central values of democracy: life, liberty, opportunity, and mutual respect. As we prepare to expand Penn's campus to the east, we strengthen our ties with our neighbors and help drive economic and technological development throughout the City and Commonwealth. At the same time, we will share the fruits of our integrated knowledge wherever there is an opportunity for our students, faculty, and alumni to serve and to learn."

Message from the Vice President of Finance





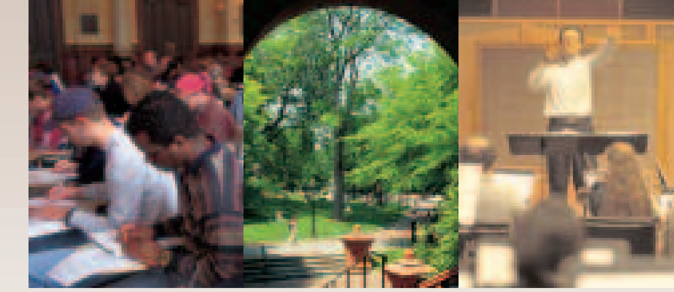
FY 05 saw the seamless transition to an era of new leadership at Penn. We welcomed a new President who, early in her tenure, defined our priorities for the coming years. President Gutmann's vision for Penn's future is one that is dependent on a sound financial base. I am pleased to report that the solid performance during FY 05 will position the University to make substantial progress towards the goals outlined in the Penn Compact.

FY 05 produced positive financial performance for the fifth straight year for the Academic and Health System components of the University. Consolidated University revenues, net assets and cash flow all showed strong growth. Contributions exhibited double digit growth as a result of the on-going generous support of our alumni and friends. Sponsored program revenues continued to trend positively.

One major accomplishment was the restructuring of $803 million of University and Health system long term debt to realize $44.8 million of present value savings. Cost-control savings were achieved in accounts receivable management, procurements, benefits and research. A special section in this report will highlight some of the technologically advanced software systems designed to support future savings.

The University's reputation in academics, healthcare and research continues to grow. Penn achieved an impressive 4th place standing in the *U.S. News and World Report* ranking of America's Best Colleges and Universities. The same publication placed four Penn schools - the Wharton School, the School of Medicine, the Law School and the Graduate School of Education - in the Top Ten list of Best Graduate Schools. For the 9th consecutive year, the Hospital of the University of Pennsylvania was named to the elite Honor Roll of American Hospitals. Moving up a notch, Penn School of Medicine ranked second in NIH funding which is a reflection of Penn's renowned research capabilities.

Significant strides were made in recruiting and retaining the best and the brightest students, faculty and staff. The caliber of the incoming freshman class continued to rise as the number of accepted applicants who chose to attend Penn reached an all-time high of 65.2%, with the matriculating class achieving average SAT scores of 1417. The addition of 140 new endowed scholarships and an increase in need-based aid helped to expand the socioeconomic diversity of our student population. Much energy was devoted to the search for, and appointment of, new leadership in a number of key academic and administrative positions. President Gutmann's executive team is now fully staffed and well positioned to lead the University forward.



Fiscal Year 2005 Performance Highlights

Total net assets increased $500.2 million for the fiscal year, primarily due to investment performance, a significant increase in contributions and improved operating performance. Penn concluded the fiscal year at June 30, 2005 with total assets of $9.3 billion, total liabilities of $2.9 billion and net assets of $6.4 billion.

The consolidated University achieved a sizable increase in net assets from operating activities of $77.0 million, an increase of $69.8 million from the previous fiscal year. The Academic Component accounted for $45.6 million of this increase primarily due to improved operations. For the fifth consecutive year, the Health System generated positive net income from operations.

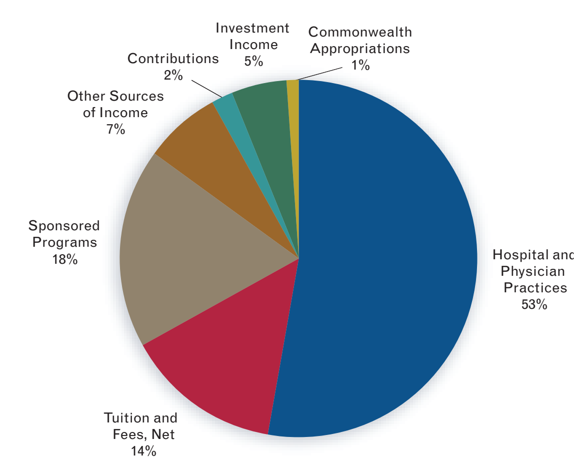
The University's total revenue increased $322.9 million, or 8.7%, to almost $4.05 billion. Hospital and physician practice revenue constituted 58.0% or $187.3 million of this overall growth in revenue, reflecting an overall increase in patient activity. Sponsored program revenue (including indirect cost recovery) grew $53.9 million or 7.9%. Tuition and fees (net of student aid) grew $33.9 million or 6.5%. Total gifts and pledges (excluding private grants) exceeded $342.8 million, a 35.4% increase over the previous fiscal year; student financial aid contributions totaled $32 million.

Total expenses increased $253.1 million or 6.8%. Hospital and physician practice expenses accounted for 67% of total growth, increasing $169.3 million or 8.9%. Instruction and research expenses grew at a 6.4% and 5.5% rate, respectively. Management and general expenses increased 2%. Expense growth was muted partially due to the outsourcing of short and long term disability as well as workers compensation benefits yielding significant one-time and annual savings.

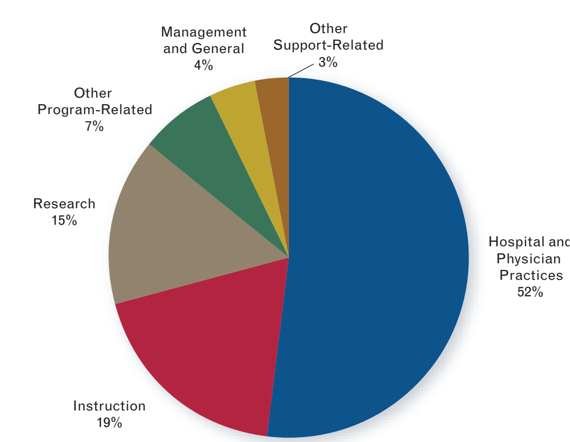
Net assets from non-operating activities increased by $423.2 million. Non-operating contributions – which include gifts for endowment and capital – totaled nearly $250 million, an increase of $85.3 million or 51.8%. Non-operating investment-related activities, which includes investment income and gains, although lower than FY 04 levels, totaled $321 million.

Short-term working capital, measured by operating cash, grew by $179.0 million in part due to improvements in the collection of receivables at the University and the Health System. Days in accounts receivable at the Health System decreased from 71 to 47 days as concentrated efforts to improve cash receipts yielded dramatic success. Cash flow from operating activities totaled $509.9 million and exceeded the previous fiscal year level by $184.1 million or 56.5 %.

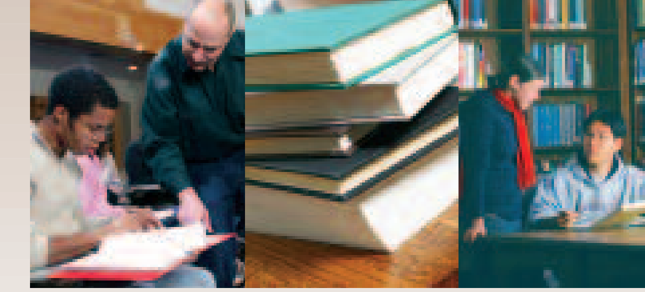
Operating Revenue by Source – $4.05 Billion



Operating Expenses by Source – $3.97 Billion



Tuition, Fees and Financial Aid



Tuition and fees (net of student aid) comprise 13.7% of Penn's total revenue. Penn received tuition dollars for its undergraduate, graduate and professional programs as well as for study abroad and executive education. Fees used to support student programs and services provided additional revenue.

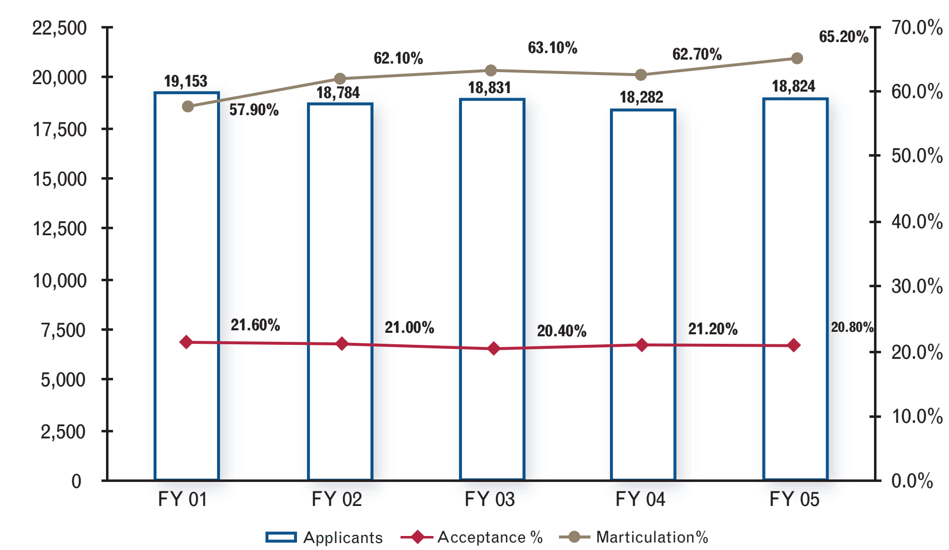
In an effort to make a Penn undergraduate education available to all outstanding students, the University continues to build on its commitment to need-blind admission and need-based financial aid by meeting the full financial needs of all admitted students. In addition, the University strengthened its need-based aid by replacing summer savings for low-income students with grants, allowing outside scholarships to supplement rather than replace Penn-funded aid, and increasing the personal allowance for students on financial aid.

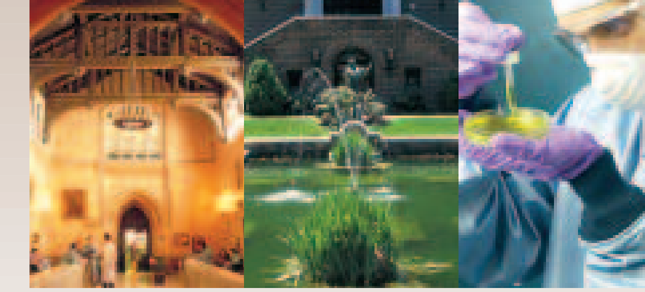
In FY 05, 4,274 undergraduates with financial need were awarded $116 million in aid. Of this total aid, $87 million was grant or scholarship, with $73 million coming from University resources. Twelve percent of University grants were funded from endowment income. The average grant-aided freshman package increased by 4.9% to $28,407. In the five-year period from FY 00 to FY 05, grants from endowment income increased by 154%, while grants from general funds increased by 33%. Overall, 6,499 undergraduates funded all or part of their education with $105 million from grants/tuition waivers, $51 million from educational loans and $16 million from work-study jobs.

A total of 6,633 graduate and professional students received $104 million in grants, including teaching and research assistantships and fellowships, $173 million in student loans, and nearly $3 million in work-study. These amounts are exclusive of research and teaching assistant stipends. During the fiscal year, Dr. Gutmann announced an 11% increase in graduate stipends for Ph.D. students in five graduate and professional schools, bringing them to parity with Penn's other schools.

Penn encourages study of the world's civilizations, economies, and environments and their interdependence. Study abroad programs facilitate a deeper understanding of other cultures and languages. Over 1,000 students participate in more than 100 programs in 36 countries which enrich their formal undergraduate education. Over the past years, aid for study abroad programs has been enhanced to eliminate financial barriers that might prevent aided students from participating. Aid packages incorporate the full estimated living expenses for these programs, even when they are higher than on-campus living expenses.

Undergraduate Applications/Admission Statistics





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, 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 $44 million or 1% of the total unrestricted revenue of the University for FY 05 was provided from Commonwealth appropriations. The Pennsylvania legislature has appropriated approximately $45 million to the University for FY 06.

The primary beneficiary of the appropriation for FY 05 was the School of Veterinary Medicine (SVM), which received $37.4 million. Support was also provided to the School of Medicine (SOM) – $5.4 million, the School of Dental Medicine (SDM) – $1.0 million, and the University of Pennsylvania Museum of Archaeology and Anthropology (MUS) – $0.2 million.

The School of Veterinary Medicine uses a substantial portion of the funds it receives from the Commonwealth to provide scholarships for every Pennsylvania resident attending the School in order to make tuition more competitive with the tuition rates charged to Pennsylvania students attending out-of-state veterinary schools. This has been a very successful program that has functioned to attract and retain highly qualified Pennsylvania residents who might have otherwise attended veterinary schools in other states.

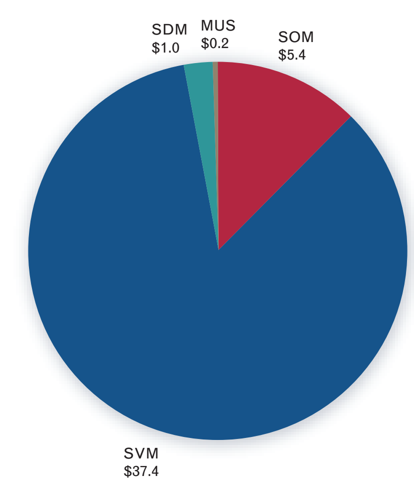
The School of Medicine's FY 05 Commonwealth appropriation was used to support medical student education. The funds were allocated to the SOM's academic offices and departments to pay for various educational costs. These include the continued development and implementation of a medical student curriculum 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 the enhancement of medical student recruitment and retention.

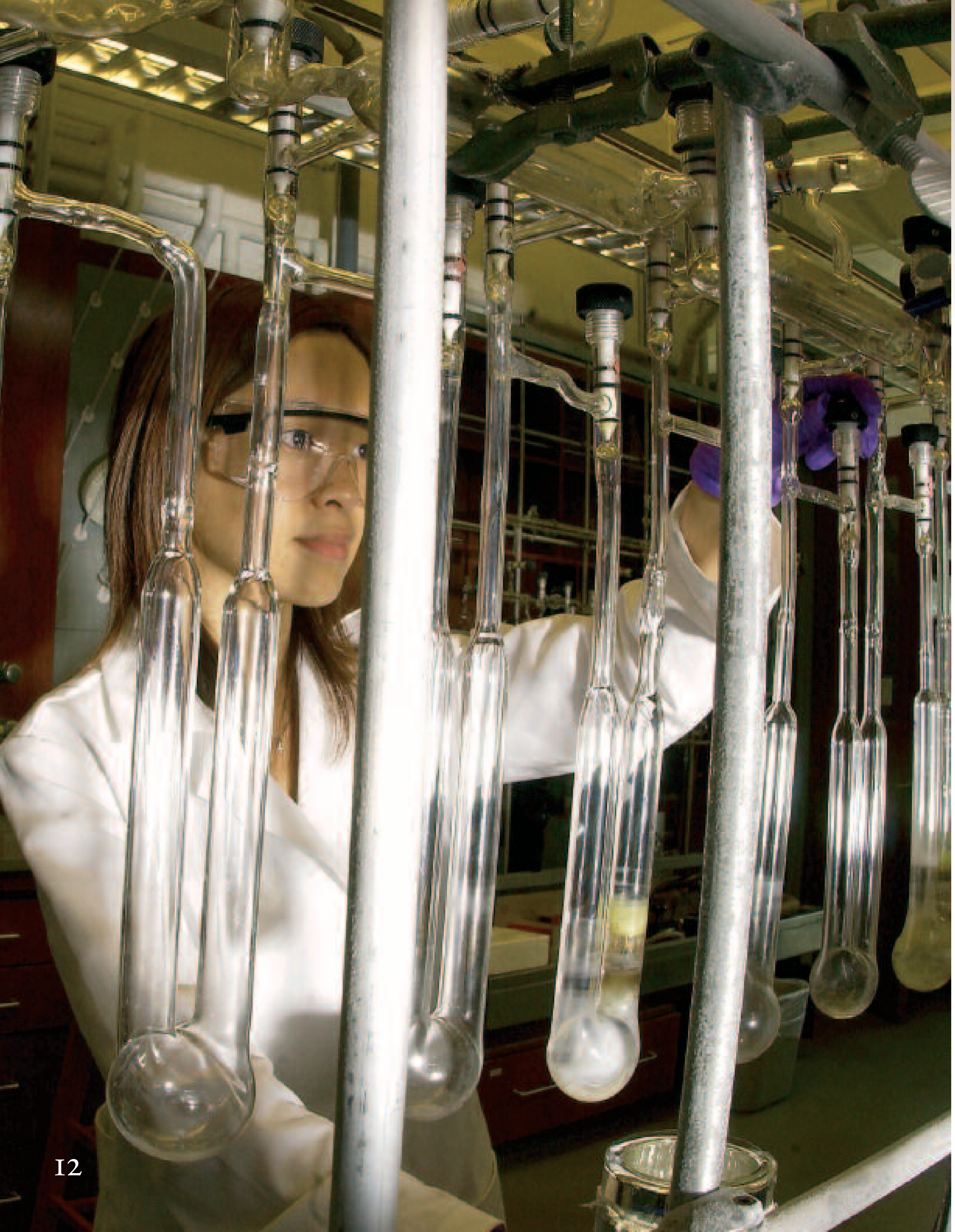
The School of Dental Medicine used its appropriation to reduce the cost of providing high quality, affordable dental care to low-income individuals from Philadelphia and neighboring counties who do not have the resources to access care from private practices. SDM uses its PennSmiles mobile van to provide more than 1,000 children with full service dental care and more than 10,000 community members with dental screening throughout West and Southwest Philadelphia.

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, uses the state funding to provide educational services to children and adults from Pennsylvania. 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.

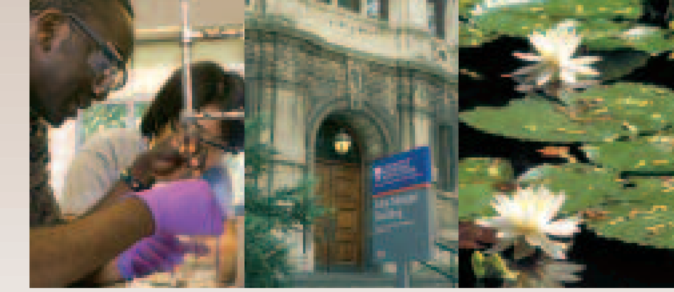
Commonwealth Appropriations

($ in millions)





Sponsored Programs

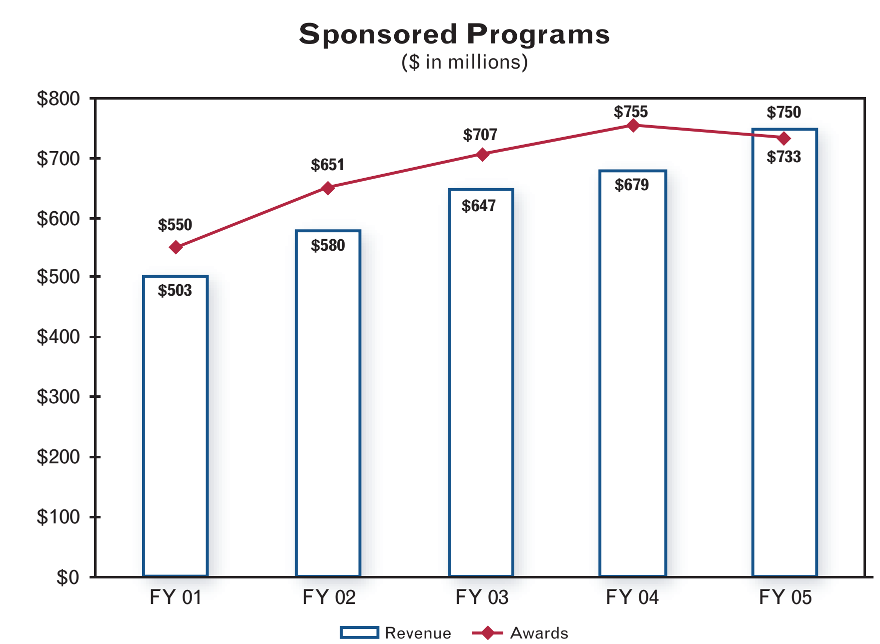


Sponsored program activity provides more than 18% of the University's total revenue. Sponsored program support includes the direct and indirect costs of sponsored research activity. In FY 05, sponsored program revenue totaled $732.6 million, an increase of almost $54 million or 7.9% compared to FY 04. The indirect cost component grew by $17.7 million to $188.4 million, an increase of 10.4%. Total awards received reached $750 million, consistent with last year's record of $755 million. $465 million or 62% of total 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 Medicine ranked second in NIH funding for the latest available federal fiscal year (FY 04).

Over the past ten years, Penn has seen significant growth in sponsored program funding. In FY 95, the University received $322 million in awards; over the decade the $428 million increase represents an annualized growth rate of nearly 8.9%. 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%. Foundation and association support increased 21.6% from $78.5 million in FY 04 to nearly $95.5 million in FY 05. Corporate support grew nearly 5% from $43.3 million to $45.6 million.

Penn's sponsored research programs are on the cutting edge of their respective fields. For example, the NASA has funded Penn physicists who are developing methods of using nanotubes- tiny tubes entirely composed of carbon atoms- to create functional electronic circuits. Led by Alan Johnson and Arjun Yodh, researchers have devised a new method of "sprinkling" nanotubes onto silicone chips. Valued for its exceptional transistor capabilities, nanotube technology is now finally available for use in electronics due to the efforts of Penn researchers.

Another indicator of the strength of Penn research program is the award from the National Institutes of Health of $9.5 million over the next three years to support the Penn Center for Molecular Discovery. The Penn team of researchers will screen the NIH repository of small molecules in an effort to discover new biological interactions. "Small molecules come in a variety of shapes and sizes that dwarf the number of genes in the human genome. Finding the important ones within the NIH repository is a classic needle-haystack challenge, but we have the robotic and biosensing tools that were not available even a decade ago," said Engineering professor Scott Diamond, director of the new center. Penn's Center is one of only nine facilities working with NIH in what is being established as the National Molecular Library Screening Center Network.



Development and Alumni Relations

Fundraising programs generated $342.8 million in new gifts and pledges during FY 05, with gift receipts totaling $299.9 million (excluding private grants). Eighty-three new gifts and pledges of $1 million or more set a new record for Penn, and 40% of those gifts came from first-time donors at that level – a very positive sign of development program growth as the University prepares to launch a comprehensive capital campaign. Annual giving produced an extraordinary $43.3 million, representing 13% growth over the previous year and also setting a new record. More than half of the gifts and pledges received during the fiscal year provided direct support for the University's academic and research programs.

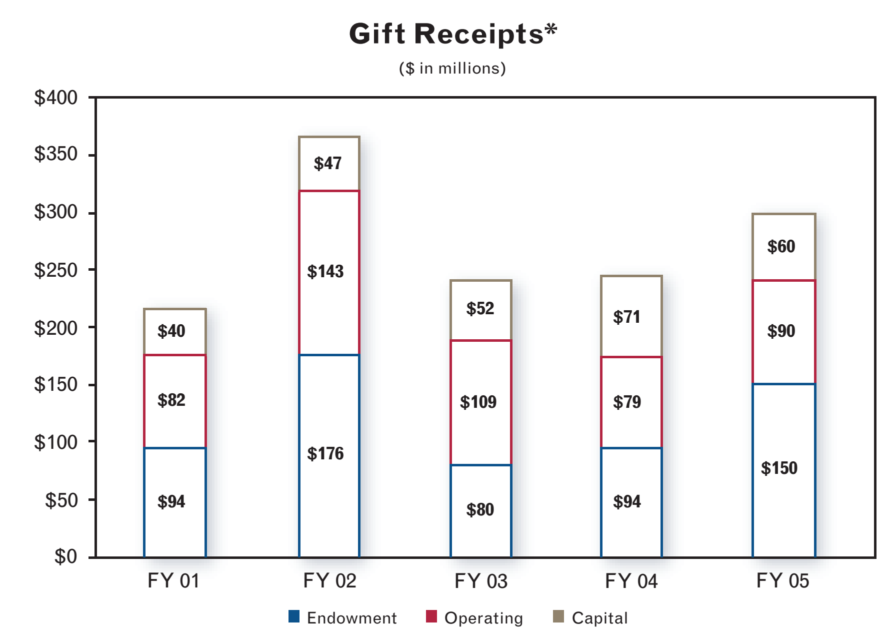
Revenue from bequests and other planned giving instruments totaled $68.7 million, to set another new record for Penn. It is also an important reflection of the long-term success of the University's development program and a critical indicator of potential for future growth.

New gifts added to the University's endowment totaled $150.4 million. Financial aid, a critical priority, received strong support during the year with the creation of 140 new undergraduate scholarships – yet another new record – adding more than $32 million to Penn's financial aid resources. More than $29 million was in the form of endowment.

Penn Integrates Knowledge, a Compact initiative to recruit eminent faculty members who will hold joint appointments across two schools, was launched with the receipt of an anonymous $10 million gift.

Responding to Dr. Gutmann's call to engage locally and globally, Penn Alumni worldwide continued to connect and reconnect with the University in unprecedented numbers during FY 05. Over the past three years, their participation in Alumni Weekend has grown by more than 50% and the interdisciplinary programming offered has expanded significantly.

During the year, nearly 4,000 alumni attended events in six major U.S. cities to welcome President Gutmann. Plans are underway for her to continue presenting the Penn Compact to the University's global alumni during FY 06 when she travels to Mumbai, Hong Kong, Singapore, and Beijing.



Endowments and Investments

Penn's endowment ended the 2005 fiscal year with $4.37 billion in investment assets. This is a remarkable accomplishment in light of the fact that the University's endowment equaled $165 million twenty five years ago.

The Associated Investments Fund (AIF), in which about 88% of the endowment is invested, ended the fiscal year with an 8.5% gain as compared to the composite benchmark of 8.7%. Fiscal year 2005 performance was driven by solid returns in both domestic and international equity markets. Despite rising oil prices and concerns about a potential housing bubble, the economy and corporate earnings held steady. The domestic equity portfolio returned 8.0% while the international equity portfolio returned 10.8%.

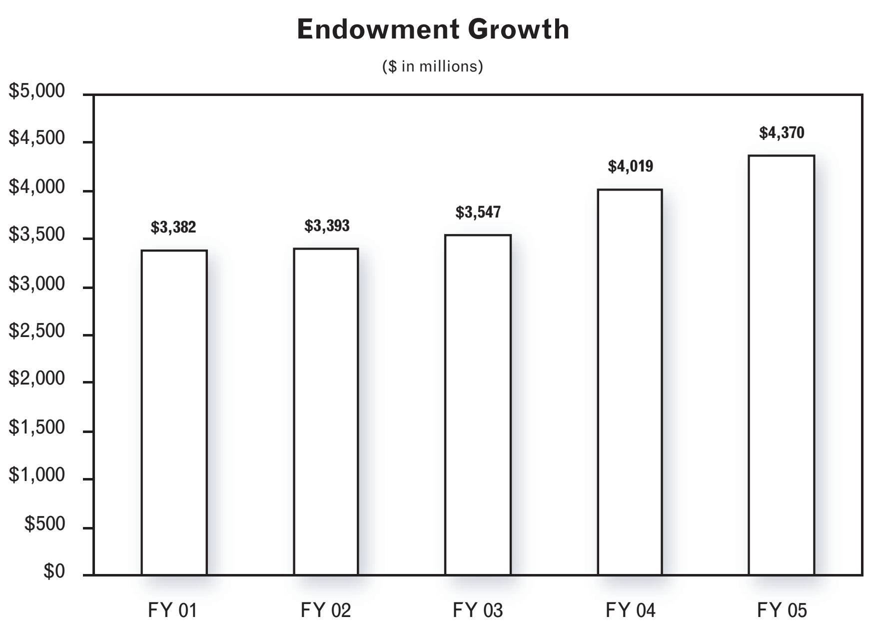
A number of market calls went in Penn's favor. International equities (where Penn is overweight its benchmark) outperformed domestic equities. Emerging market equities also did particularly well for the fiscal year, and Penn benefited from having increased its allocation. Although Japan underperformed as a market, Penn's activist managers delivered strong double digit returns.

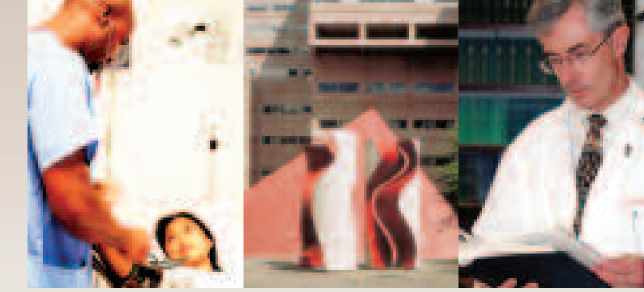
The absolute return (hedge fund) portfolio achieved 11.9% outperforming equities. Distressed debt continued to be a major contributor to return although most managers have been steadily reducing their exposure. Many funds are now net long equity markets; this was also a positive contributor to returns over the course of the fiscal year.

Penn's fixed income portfolio returned 4.0% as long rates finished the year with little change despite a series of rate hikes. Penn underperformed modestly as a result of having reduced the duration of the portfolio in anticipation of an increase in long rates.

Real estate, private equity and natural resources comprise a small portion of the total portfolio. Penn is a relatively new investor in these asset classes and has yet to see the benefits of many of these investments; however, these asset classes will be the subject of renewed focus going forward.

For the three year period that ended June 30, 2005, Penn gained 9.9% per annum as compared to a composite benchmark of 8.8%. For the five year period, Penn returned 7.0% per annum as compared to a composite benchmark of 2.2%.





University of Pennsylvania Health System

In FY 05, the University of Pennsylvania Health System, comprising the health-services component of PENN Medicine, significantly strengthened its financial performance. For the fifth consecutive fiscal year, UPHS generated a surplus, with a net operating margin of $72.5 million (excluding investment income). This performance was achieved during a year in which UPHS provided $50 million in uncompensated care. Outpatient visits involving the Penn hospitals and the faculty practices (Clinical Practices of the University of Pennsylvania -- CPUP) increased by 1.1% and admissions increased by 2.7%. Surgical admissions increased by 9.5%

The Health System's strong operating performance was attained in part through measures undertaken to increase revenue and reduce expenses, including the revenue cycle enhancement project, focus on key service lines (such as surgery, cardiology, and orthopedics), and supply chain initiatives. The UPHS operating performance was also enhanced by initiatives by the Clinical Effectiveness & Quality Initiatives program (CEQI). In addition, the Health System's debt was completely restructured. These measures yielded significant net present value savings.

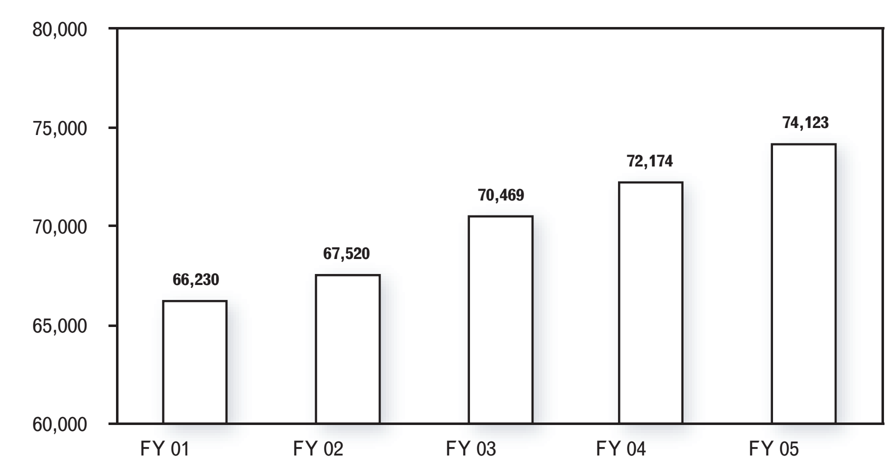
For the ninth consecutive year, HUP was named to the Honor Roll of American hospitals by *U.S. News & World Report*. It was one of only 16 hospitals in the country to receive this honor and the only one in the Delaware Valley. *U.S. News* also commended HUP in 13 medical specialties.

Penn Presbyterian Medical Center was again listed among the top 100 cardiovascular hospitals in the country by Solucient, a company specializing in health-care information. For the fifth year in a row, *Hospitals & Health Networks*, a publication of the American Hospital Association, selected UPHS for a "Most Wired" award. This year, *Philadelphia Magazine* named 137 Health System physicians to its list of the region's best doctors.

Several components of PENN Medicine, including HUP, Penn Presbyterian, CPUP and the School of Medicine, have been involved in development of the West Philadelphia Master Plan. This comprehensive assessment of the Health System's facilities needs and priorities in West Philadelphia outlines options for development and expansion over the next decade. Like the creation of the Center for Advanced Medicine, the West Philadelphia Master Plan is an example of the Health System's engagement with our local community, which will be significantly enhanced by these developments.

In FY 05, UPHS funded three new multidisciplinary research institutes that will support the academic missions of PENN Medicine. These are the PENN Cardiovascular Institute; the Institute for Diabetes, Obesity, and Metabolism; and the Institute for Translational Medicine and Therapeutics. All three will integrate knowledge from a wide range of Penn experts, and focus on translational medicine that will bring the fruits of research swiftly and safely to patients.

Adult In-Patient Admissions



Other Sources of Income

Auxiliary programs account for $298 million or 7.4% of consolidated University revenue. Although the bulk of Penn's revenue is generated through its academic, health and research programs, these sources represent an integral part of life on campus. Students, faculty, staff, alumni and the community benefit from the services provided by many diverse operations.

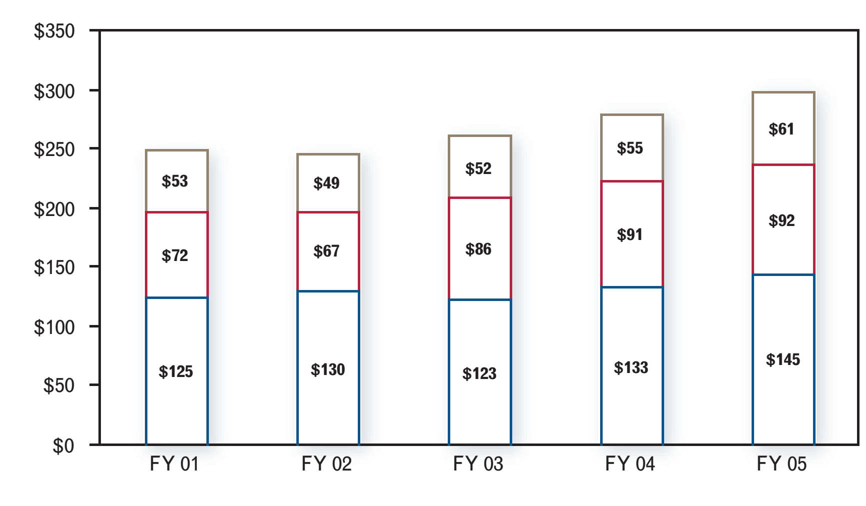
Of the 48,000 people who live, learn and work on Penn's 269-acre West Philadelphia campus, approximately 7,000 students reside in the twelve college houses and three graduate residences. As part of that residential experience, students can choose a wide variety of dining options using flexible dining dollars. The average cost of room and board is $5,698 and $3,672 respectively.

Students and staff can take advantage of the educational discounts provided by the Computer Connection on computers, hardware, software and related accessories. The Penn Bookstore, the hub of retail activity on 36th and Walnut streets is operated by Barnes and Noble. Innovative marketing and collaboration with our suppliers on back-to-school and winter promotions enabled Penn to increase revenue at the Computer Connection by 10% and the Bookstore by 6%.

Alumni and visitors to campus take advantage of a wide array of educational, cultural and social opportunities. A number of Penn's schools offer lifelong learning and executive education programs that attract an ever-increasing number of working professionals from around the world. For example, Wharton's Executive Education program saw strong growth in its custom programs that translated into higher hotel revenues at the Steinberg Conference Center. Other Penn hotels also experienced revenue growth including the Hilton Inn at Penn, the Penn Tower Hotel and the Sheraton University City. Combined gross revenue for these hotels increased 11% from the previous year.

The community benefits from health care related activities, such as adult health center patient care and veterinary hospital animal care. The School of Nursing's Living Independently for Elders (LIFE) program is an adult day health center for managing the medical, functional and psycho-social problems faced by elderly patients. The LIFE program is run at two West Philadelphia locations. At year-end, LIFE's program enrollment increased by 25% year-over-year, a contributing factor in Penn's Other Income growth. Penn's Ryan Veterinary Hospital, which serves small animals, and Widener Veterinary Hospital, which serves large animals, generate revenue by providing small and large animal care services. These and other community-related services account for approximately 25% of total Other Sources of Income.

Other Sources of Income
($ in millions)



Capital Investments

During FY 05, the University invested $256 million in property, plant and equipment. Many major capital projects were initiated, continued and completed in support of its academic, research, student life and Health System components.

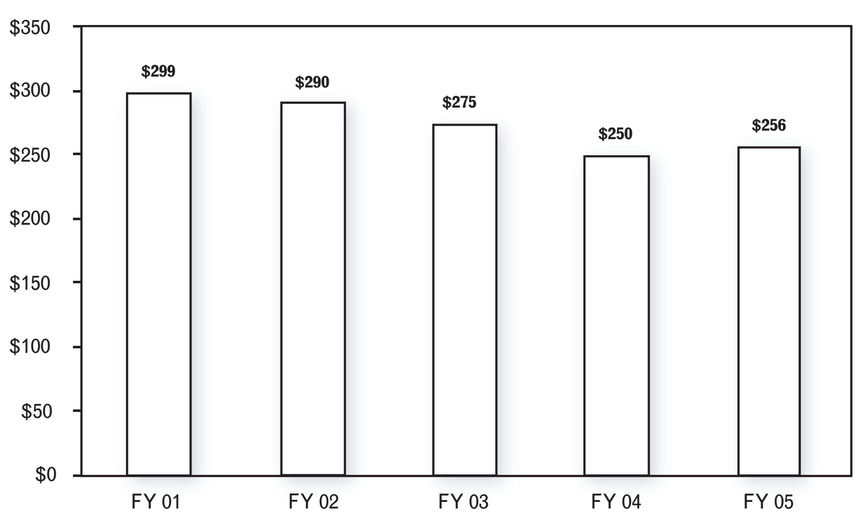
Looking at the academic and research blueprints, construction began on the McNeil Center for Early American Studies and moved forward on Skirkanich Hall, the Veterinary Medical Teaching and Research Building and the Lynch Life Sciences Laboratories. Renovations are underway on Vance Hall as well as on the Evans Clinic and progressed on the Nursing Education Building and Fischer-Bennett Hall. The Translational Research Laboratory, a state of the art research facility adjacent to Penn's campus, was completed by external developers and is ready for its tenants, principally from the School of Medicine. Plans are underway for the construction of the Annenberg Public Policy Center Building which will be funded by an extraordinary gift of $30 million from the Annenberg Foundation and the Annenberg Foundation Trust at Sunnylands.

Projects to improve student living that are in progress or have been completed included renovations to the fire alarm and sprinkler systems in Hamilton, Hill and English College Houses and Sansom Place West. WXPN, Penn's FM radio station was relocated to a newly renovated space on the east end of campus co-located with the World Café Live, an independent live performance venue and restaurant.

In FY 05, the Health System made steady progress on its Center for Advanced Medicine, which will house the Abramson Cancer Center and cardiovascular services, as well as ambulatory operating rooms and procedures suites. Preparation of the site is nearly complete. Other major facilities projects also under way or completed in FY 05 include four new operating rooms and an 18-bed Post-Anesthesia Care Unit at HUP, as well as a new 25-bed inpatient unit. At Penn Presbyterian, a new cardiac catheterization lab was added and significant upgrades were made to the operating rooms to accommodate several new surgical programs. Among the facilities improvements in our clinical practices (CPUP) were the new ambulatory Neurosurgery space and nine new chemotherapy bays.

Purchase of Plant, Property and Equipment

($ in millions)



Information Technology

Nowhere is transition more evident than in the fast-paced, ever-changing world of information technology. Penn recognizes the critical need to address its underlying electronic infrastructure in order to keep pace with incredible advances in global technology and the ubiquitous nature of the web.

"Keeping pace" involved the acquisition, development and implementation of new software systems as well as the continued expansion of data stores and the access to, and security of, Penn's information assets. The results yielded integrated, web-based information systems designed to meet individual needs for access to personal information and expertise such as U@Penn, an employee self service portal, as well as the transactional and analytical systems that meet current needs and future demands for consistent data management and reporting throughout the University. While many systems were replaced or upgraded in FY 05, we've highlighted three that represent enhancements in the research, development and health arenas.

Federal guidelines for research administration increasingly require electronic submission and certification of effort expended in the support of sponsored programs, projects and awards. More than 7,500 research personnel participate in the certification process and will benefit from the introduction of Penn's electronic Effort Reporting. Similarly, Penn's Electronic Research Administration system or PennERA is being developed and streamlined to provide a full range of electronic services from initial identification of funding opportunities to proposal and protocol development to submission and historical reporting.

Increasing contributions through relationship management is a dynamic activity vital to the support of the University's mission. Managing the data on over 275,000 alumni worldwide requires a sophisticated infrastructure and technology that can expand and evolve over the next decade. The Advancement Project is a joint effort of the Office of Development and Alumni Relations, the Division of Finance, and Information Systems and Computing to integrate and improve current alumni, donor, and gift administration systems. A major component of the project, the Atlas database system, has been designed to support staff efforts to manage complex donor/alumni relationships and consolidate gift and financial reporting.

UPHS has continued to improve patient care in tangible ways. For example, it implemented the Eclypsis Sunrise Computerized Physician Order Entry (CPOE) at Penn Presbyterian and upgraded the system at HUP. The Health System plans to implement the same system at Pennsylvania Hospital in the coming year as well. CPOE is designed to streamline the ordering process and to provide an array of medication order checks and other capabilities for decision support. In FY 05, the Health System also implemented Penn e-lert, a system that permits live coverage of intensive care units by off-site intensivists, using a comprehensive telemedicine system.

Summary and Future Outlook

The fiscal year ending June 30, 2005 was another year of high achievement at Penn. As Penn's reputation grows around the world, it has become the first choice for exceptional students as evidenced by the highest matriculation rate and SAT scores ever attained by our freshman class. Building on its increasing momentum, the Health System posted its fifth consecutive year of positive operating performance. Penn's commitment to serve humanity was demonstrated by its response to the tsunami in Indonesia, with teams of educators and undergraduate students traveling to Aceh province and Sri Lanka to assist in the long-term educational recovery process.

Moving forward, we face a number of opportunities and challenges as we weather rising inflation and an uncertain global economic forecast. Recent national and world events already have had an impact on the future. Within days of Hurricane Katrina, Penn accepted 120 students from Gulf Coast area universities, waiving fall tuition to allow these students to continue their education uninterrupted while their home schools rebuilt. At the same time, Dr. Gutmann announced a program to give Penn employees paid leave to serve in the rebuilding effort; doctors, nurses and other medical professionals from UPHS and the Schools of Medicine, Veterinary Medicine and Nursing were among the first responders. The economic impact from Katrina will put pressure on the availability and cost of building materials as well as add to the already burgeoning price of energy. This will, in turn, affect capital plans and operational costs in the upcoming fiscal year.

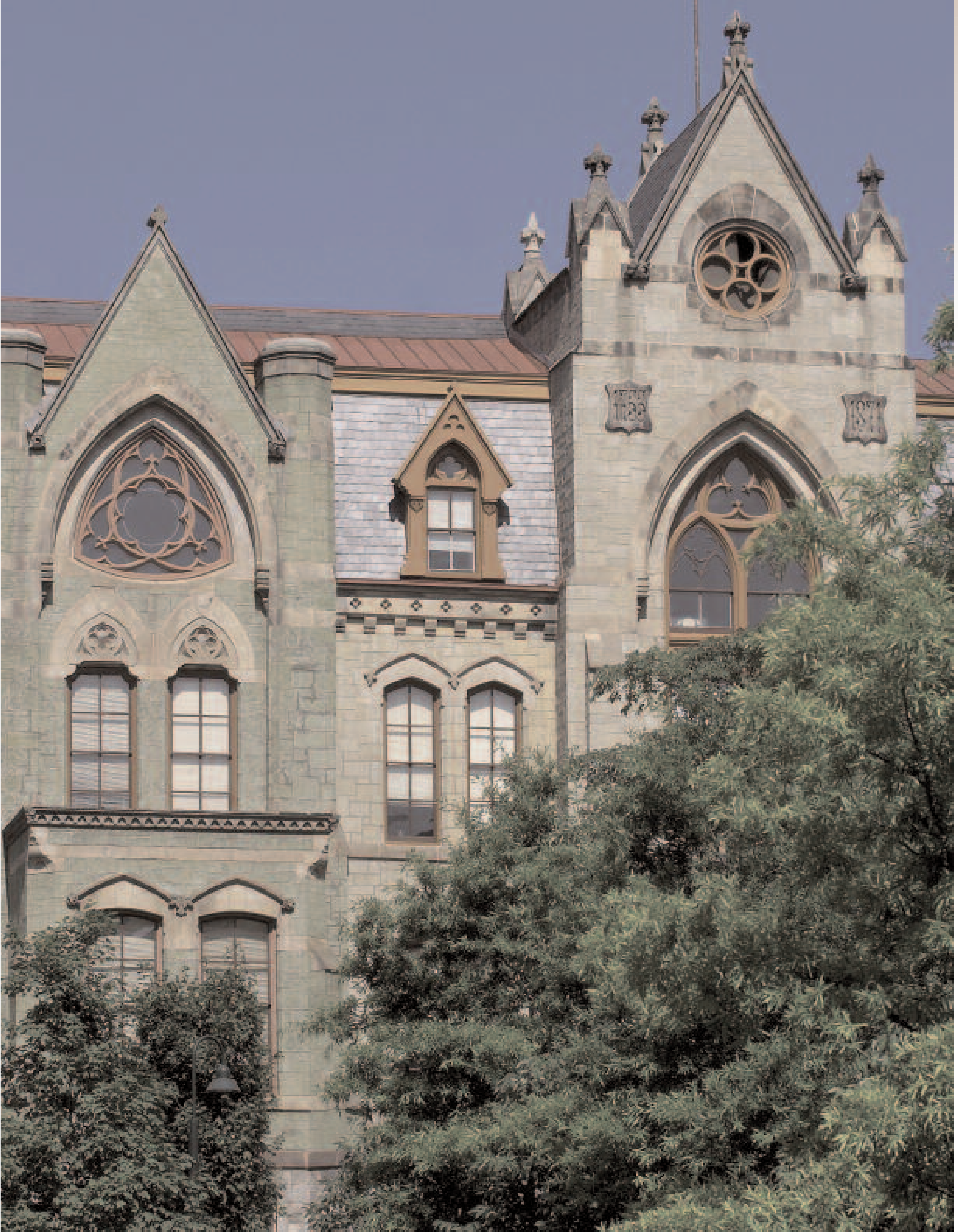
As the largest private employer in the city of Philadelphia and the second largest in the Commonwealth of Pennsylvania, Penn, with its 24,000 employees, adds substantial economic impact to the city and region. Balancing the growth of the campus with the needs of the West Philadelphia community engages us in a mutual effort to enhance our vibrant campus and neighborhoods. The planned expansion of the campus to the east, utilizing the recently acquired postal lands, plus the ground-breaking for the Center for Advanced Medicine on the site of the former Convention Center, are two monumental capital initiatives that will strengthen Penn's links with the city and region and position Penn to become a premier global research university for the 21st century.

Led by Dr. Gutmann, the senior leadership team of the University of Pennsylvania is keenly aware of its stewardship and management responsibilities in the governance of the institution. The University's senior leadership continues to collaborate effectively in identifying opportunities to increase efficiencies, contain costs, create additional resources, and improve the quality of life on campus. Our ability to meet these challenges relies on valuable contributions from our distinguished faculty, dedicated staff and our generous alumni and friends.

As we look ahead to the tercentennial celebration of the birth of our founder, we can take pride in our past accomplishments as we continue to enthusiastically embrace the challenges of the future. Quoting Benjamin Franklin, "An investment in knowledge pays the best interest."

Scott R. Douglass

Scott R. Douglass
Vice President for Finance
and Treasurer



a five-year review of investments

(thousands of dollars)

	2005	2004	2003	2002	2001
Investments:					
Investments:*					
Fair Value					
Stocks	$2,155,577	$1,932,096	$1,548,636	$1,689,648	$1,902,998
Bonds*	1,122,377	1,017,242	1,101,299	1,095,028	832,018
Short-term*	331,897	367,685	354,914	303,812	343,810
Real estate	172,536	131,087	133,367	171,924	120,128
Absolute value	712,546	594,323	498,394	334,691	245,634
Private equity	159,279	118,154	81,875	64,882	65,410
Other	18,854	4,757	6,432	12,479	39,222
Total Investments	$4,673,066	$4,165,344	$3,724,917	$3,672,464	$3,549,219
Endowment:					
Fair Value	$4,369,782	$4,018,660	$3,547,473	$3,393,297	$3,381,848
Associated Investments Fund:					
Fair Value	$3,873,965	$3,356,467	$2,859,041	$2,772,040	$2,800,390

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

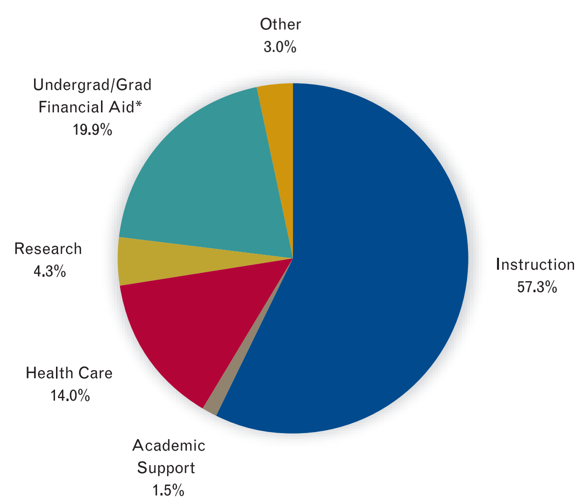
endowment

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, 2005, the endowment had a market value of $4.37 billion. 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 endowment grew by $351 million net of a $183 million distribution to endowment beneficiaries. This reflects investment gains of $339 million as well as gifts and transfers of $195 million. For the fiscal year ended June 30, 2005 distributions from the endowment funded 3.8% of the University's consolidated operating budget.

Endowment by Purpose



* Includes graduate stipends

associated investments fund

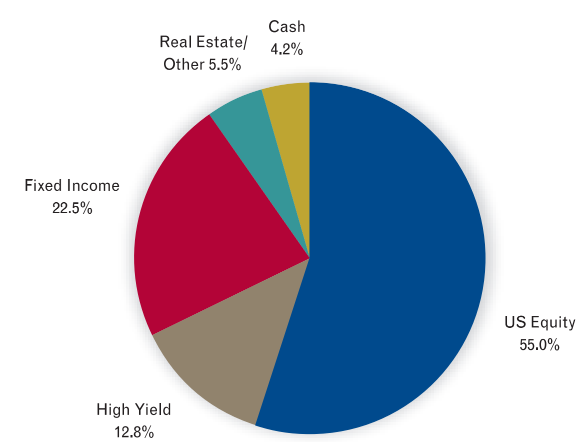
The vast majority of the University's endowment is invested in the Associated Investments Fund (AIF), a pooled investment vehicle in which individual endowments and trusts hold individual shares or units. The AIF had a market value of $3.875 billion as of June 30, 2005.

The AIF is managed by the Office of Investments under the supervision of an Investment Board appointed by the Trustees. Funds are invested with external managers in accordance with a strategic asset allocation that aims to maximize total return from both current income and capital appreciation without excessive risk. Over the last decade, the University has taken a number of measures to diversify the AIF by reducing the allocation to domestic equity and fixed income and by increasing the allocation to international equities, absolute return, private equity, real estate and natural resources. Diversification is expected to both enhance returns and reduce risk.

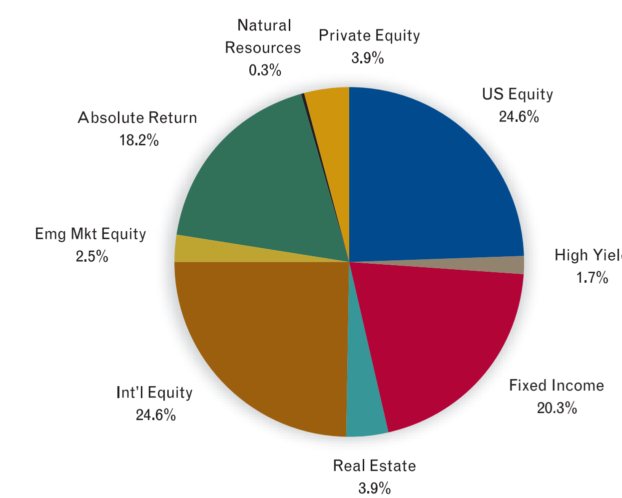
associated investments fund

For fiscal 2005 the endowment generated an investment return of 8.5% as compared to the composite benchmark of 8.7%. The economy held steady, corporate earnings were strong and the stock markets continued to rise albeit at a slower pace than in the preceding fiscal year. The endowment benefited from an overweight to international equity and from outperformance in absolute return. Private equity, real estate and natural resources did not have a material impact on endowment performance this year given that these portfolios are both small and immature. Fixed income exerted a moderate drag on performance given already low yields with little room for further interest rate reductions.

AIF Asset Allocation 6/30/95



AIF Asset Allocation 6/30/05



As shown below, the endowment has consistently matched or outperformed both its composite benchmark and a simple 70/30 benchmark made up of the Russell 3000 and Lehman Government/Credit indices. The endowment has done particularly well in both absolute and relative terms in the five years between June 30, 2000, and June 30, 2005, at a time when the markets have undergone significant turmoil.

Total Return Performance Comparison

Periods Ended June 30, 2005
Annualized Returns (%)

Category	10 Years	5 Years	3 Years	1 Year
Associated Investments Fund (A.I.F.)	9.6	7.0	9.9	8.5
Composite Index *	8.6	2.2	8.8	8.7
70% Russell 3000/30% Lehman Govt/Credit	9.4	1.7	9.2	8.2

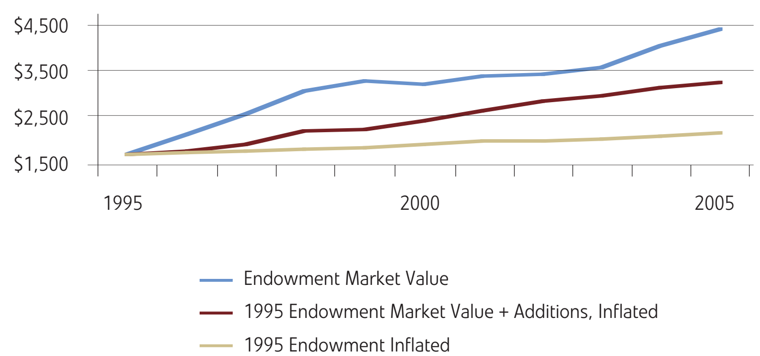
* The Composite Index is a benchmark that weights the Russell 3000, MSCI World ex-US, MSCI Emerging Markets Equity, NCREIF, Citigroup High Yield, and Lehman Gov't. indices proportional to the weights of the underlying assets classes in the AIF strategic asset allocation.

associated investments fund

Penn's five-year return of 7.0% puts it in the top third of its peers, defined as endowments with over $1 billion in assets. However, Penn lagged its peers for the 2005 fiscal year due to lack of exposure in high returning asset classes such as private equity, real estate, emerging markets and natural resources. Many of our peers made significant allocations in these areas five or more years ago and are now reaping the benefits. The median return for endowments with over $1 billion in assets for fiscal 2005 was 12.0%.

Investment performance has significantly added to the value of the endowment over both inflation and gifts as shown below.

Endowment Growth vs. Inflation



AIF Spending

The University's endowment spending policy is designed to smooth the impact of short-term market moves that may affect the endowment's market value. The spending policy aims to make future endowment distributions more predictable for purposes of managing and planning the University's operating budget. For Fiscal Year 2005 the spending policy is 4.7% of the three-year average market value of the AIF, lagged by one year. The market value of the AIF is calculated net of all external management fees and net of the internal costs of managing the endowment.

During fiscal 2005 the total amount distributed under the spending policy was $140.5 million of which $28 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 4.8% annually.

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 35 to 56, have been prepared in accordance of 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 auditors during their audit were valid and appropriate. PriceWaterhouseCoopers' audit opinion is presented on page 34.

The University maintains a system of external 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 weaknesses 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 the internal control system can change with circumstances.

The trustees of the University of Pennsylvania, through the 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 carry out their responsibilities. Both internal auditors and the independent auditors have full and free access to the Committee on Audit and Compliance.

Amy Gutmann President	Craig R. Carnaroli Executive Vice President	Scott R. Douglass Vice President for Finance and Treasurer	John Horn 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, 2005, 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 2004 financial statements, and in our report dated September 10, 2004, 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.

PricewaterhouseCoopers LLP

November 14, 2005

statement of financial position

(thousands of dollars)

	June 30, 2005	June 30, 2004
Assets		
Cash and cash equivalents	$ 711,422	$ 532,388
Accounts receivable, net of allowances of $10,763 and $12,780	140,653	127,919
Patient receivables, net of allowances of $89,808 and $96,511	255,885	378,396
Contributions receivable, net	257,776	220,779
Loans receivable, net of allowances of $3,147 and $3,466	196,467	194,843
Other assets	138,346	105,660
Assets held for sale		44,921
Investments, at fair value	4,859,151	4,312,544
Plant, net of depreciation	2,760,840	2,716,663
Total assets	$ 9,320,540	$ 8,634,113
Liabilities		
Accounts payable	$ 91,943	$ 93,039
Accrued expenses and other liabilities	751,728	664,112
Collateral due broker	186,087	147,200
Liabilities associated with assets held for sale		6,686
Deferred income	76,210	69,648
Deposits, advances, and agency funds	116,979	119,447
Federal student loan advances	78,328	78,712
Accrued retirement benefits	273,309	215,032
Debt obligations	1,358,041	1,352,517
Total liabilities	2,932,625	2,746,393
Net assets		
Unrestricted	3,086,908	2,871,551
Temporarily restricted	1,552,907	1,422,228
Permanently restricted	1,748,100	1,593,941
	6,387,915	5,887,720
Total liabilities and net assets	$ 9,320,540	$ 8,634,113

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

statement of activities

(thousands of dollars)

for the year ended June 30, 2005
(with summarized financial information for the year ended June 30, 2004)

	Unrestricted	Restricted Temporarily	Restricted Permanently	2005	2004
Revenue and other support:					
Tuition and fees, net	$ 552,933			$ 552,933	$ 518,992
Commonwealth appropriations	44,022			44,022	42,946
Sponsored programs	732,607			732,607	678,724
Contributions	42,150	$ 50,833		92,983	88,616
Investment income	102,087	86,190		188,277	165,747
Hospitals and physician practices	2,137,164			2,137,164	1,949,818
Sales and services of auxiliary enterprises	92,335			92,335	91,187
Other income	144,830			144,830	132,534
Independent operations	61,057			61,057	54,780
Net assets released from restrictions	141,995	(141,995)			
	4,051,180	(4,972)		4,046,208	3,723,344
Expenses:					
Program:					
Instruction	767,353			767,353	721,299
Research	579,417			579,417	549,404
Hospitals and physician practices	2,077,749			2,077,749	1,908,452
Auxiliary enterprises	106,719			106,719	104,926
Other educational activities	118,956			118,956	118,737
Student services	37,853			37,853	37,831
Support:					
Academic support	55,629			55,629	56,657
Management and general	165,961			165,961	162,741
Independent operations	59,603			59,603	56,098
	3,969,240			3,969,240	3,716,145
Increase (decrease) in net assets before nonoperating revenue, net gains, reclassifications and other	81,940	(4,972)		76,968	7,199
Nonoperating revenue, net gains, reclassifications and other:					
Gain on investment, net	82,842	147,125	$ 10,394	240,361	437,088
Investment income, net of amounts classified as operating revenue	(18,142)	(38,379)	1,003	(55,518)	(54,759)
Contributions	32,900	73,902	143,019	249,821	164,559
Change in minimum pension liability	(43,432)			(43,432)	2,441
Income from discontinued operations	32,455			32,455	2,714
Transfers to Phoenixville Foundation		(203)	(257)	(460)	
Net assets released from restrictions	46,794	(46,794)			
Increase in net assets	215,357	130,679	154,159	500,195	559,242
Net assets, beginning of year	2,871,551	1,422,228	1,593,941	5,887,720	5,328,478
Net assets, end of year	$3,086,908	$1,552,907	$1,748,100	$6,387,915	$5,887,720

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

statement of cash flows

(thousands of dollars)

for the years ended June 30, 2005 and 2004

	2005	2004
Cash flows from operating activities:		
Increase in net assets	$ 500,195	$ 559,242
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	209,719	202,670
Provision for bad debts	133,755	135,543
Loss on extinguishment of debt	16,736	
Gain on investments, net	(240,361)	(437,088)
Loss on disposal of plant, property and equipment	9,275	2,619
Nonoperating income designated for the acquisition of long-lived assets and long-term investment	(193,843)	(109,800)
Change in minimum pension liability	43,432	(2,441)
Changes in operating assets and liabilities:		
Patient, accounts and loans receivable	(40,932)	(130,336)
Contributions receivable	2,758	5,356
Other assets	(29,853)	12,001
Accounts payable, accrued expenses and accrued retirement benefits	94,709	67,809
Deposits, advances and agency funds	(2,296)	10,887
Deferred income	6,562	9,279
Net cash provided by operating activities	509,856	325,741
Cash flows from investing activities:		
Purchase of investments	(4,239,304)	(5,045,240)
Proceeds from sale of investments	4,068,069	5,035,319
Purchase of plant, property and equipment	(255,992)	(250,055)
Net cash used by investing activities	(427,227)	(259,976)
Cash flows from financing activities:		
Proceeds from contributions received designated for the acquisition of long-lived assets and long-term investment	156,680	102,868
Federal student loan advances	(384)	328
Repayment of long-term debt	(857,121)	(184,186)
Proceeds from issuance of long-term debt	797,230	154,788
Net cash provided by financing activities	96,405	73,798
Net increase in cash and cash equivalents	179,034	139,563
Cash and cash equivalents, beginning of year	532,388	392,825
Cash and cash equivalents, end of year	$ 711,422	$ 532,388
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 42,931	$ 54,945
Non-cash activity		
Due to First Hospital Foundation		$ 607

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, 2004 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, 2005, the University's principal derivative

financial instruments are international equity future contracts and forward currency contracts. For the fiscal year ended June 30, 2004, the University's principal derivative financial instruments were forward currency contracts. Alternative investments that include hedge funds, private equity and real estate investments held through limited partnerships or commingled funds are carried at estimated fair value provided by the management of the alternative investment partnerships or funds as of March 31, 2005 and 2004, as adjusted by cash receipts, cash disbursements, and securities distributions through June 30, 2005 and 2004.

The University believes that the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2005 and 2004. Because alternative investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed and such differences could be material.

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, natural resources, 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, 2005 and June 30, 2004, 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. Intangible assets, including acquisition costs, the excess of cost over net assets acquired, and non-competition agreements related to the acquired physician practices, net of accumulated amortization were fully amortized at June 30, 2005 and June 30, 2004. These intangible assets were amortized on a straight-line basis over five years or the lives of the respective non-competition agreements. Goodwill of $33,184,000 at June 30, 2005 and $34,843,000 at June 30, 2004 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 $143,384,000 in 2005 and $134,355,000 in 2004.

Sponsored Programs

The University receives grant and contract revenue from governmental and private sources. In 2005 and 2004, grant and contract revenue earned from governmental sources totaled $621,211,000 and $575,706,000, 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

The Trustees of the University of Pennsylvania formed Penn Medicine which is the governance structure that 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.

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, 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, 2005 and 2004, UPHS 's net liability to the University was $3,783,000 and $6,782,000, 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 $27,198,000 and $29,673,000 in 2005 and 2004, 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. There were no significant settlements in 2005.

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 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, 2005 and 2004, prior to eliminations for transactions between UPHS and other entities of the University, is as follows (in thousands):

	2005	2004
Net patient service	$ 2,043,862	$ 1,863,694
Other revenue	126,657	114,484
Total expenses	(2,075,887)	(1,922,751)
Excess of revenues over expenses from operations	94,632	55,427
Other unrestricted income, net	(223)	2,266
Excess of revenue over expenses	94,409	57,693
Nonoperating, net	(17,358)	27,017
Increase in net assets	$ 77,051	$ 84,710
Total current assets	$ 552,869	$ 588,053
Assets whose use is limited (including board designated funds of $345,514 and $293,966 and trustee held funds of $129,363 and $19,576 for 2005 and 2004, respectively)	935,697	750,286
Plant, net of depreciation	594,795	588,315
Investments and other assets	73,498	51,149
Total assets	$ 2,156,859	$ 1,977,803
Total current liabilities	$ 336,620	$ 346,571
Long-term debt, net of current portion	774,591	750,377
Other liabilities	387,034	299,292
Total liabilities	$ 1,498,245	$ 1,396,240
Net assets		
Unrestricted	249,922	194,008
Temporarily restricted	289,045	270,880
Permanently restricted	119,647	116,675
Total net assets	658,614	581,563
Total liabilities and net assets	$ 2,156,859	$ 1,977,803

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, 2005 and 2004, was $620,000 and $2,714,000, respectively, and is included in Income from discontinued operations in the accompanying Statement of Activities. Phoenixville Hospital had net revenues of $8,855,000 and $102,535,000 for the years ended June 30, 2005 and 2004, respectively.

The sale was completed on August 1, 2004, resulting in a gain of approximately $31,835,000. Additionally, long-term debt and capital leases of $33,954,000 were retired as a result of this transaction.

3. Investments

A summary of investments, stated at fair value, at June 30, 2005 and 2004 is as follows (in thousands):

	2005	2004
Short-term	$ 517,983	$ 427,382
Stocks	2,155,577	1,925,601
Bonds	1,122,377	1,111,323
Real estate	172,536	130,087
Absolute return	712,546	596,323
Private equity	159,279	118,154
Natural resources	14,812	–
Other	4,041	3,674
End of year	$ 4,859,151	$ 4,312,544
Beginning of year	$ 4,312,544	$ 3,993,603

Included in investments are assets held in trust for the University with an aggregate fair value of $320,370,000 at June 30, 2005 and $309,172,000 at June 30, 2004.

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, 2005 and 2004, short-term investments held under this arrangement aggregated $3,715,000 and $4,829,000, respectively.

At June 30, 2005 and 2004, investments with a fair value of $133,676,000 and $31,871,000, respectively, were held by trustees under indenture and escrow agreements.

Included in investments is $4,925,000 and $755,000 of cash that is held in escrow at June 30, 2005 and 2004, respectively.

At June 30, 2005 and 2004, investments with a fair value of $179,465,000 and $143,454,000, 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 $186,087,000 and $147,200,000 at June 30, 2005 and 2004, respectively. The University is indemnified against borrower default by the financial institution that is acting as its lending agent.

At June 30, 2005 and 2004, short-term investments include $3,015,000 and $8,001,000, respectively, of investments sold receivables. At June 30, 2005 and 2004, short-term investments include $4,629,000 and $2,507,000, respectively, of investments purchased payables.

The University is obligated under certain limited partnership investment fund agreements to advance additional funding periodically up to specified levels. At June 30, 2005, the University had unfunded commitments of $276,300,000, which are estimated to be drawn through 2011.

A summary of the University's total investment return for the years ended June 30, 2005 and 2004 as reported in the Statement of Activities is presented below (in thousands):

	2005	2004
A.I.F. investment income	$ 83,038	$ 70,295
A.I.F. realized and unrealized gains and (losses)	234,784	417,769
Return on A.I.F.	317,822	488,064
Other investment income, gains and losses	55,298	60,012
Total return on investments	$ 373,120	$ 548,076

Income distributed for operations under the A.I.F. spending rule exceeded available income, net of expenses and net of income permanently reinvested, by $73,142,000 in 2005 and by $68,335,000 in 2004.

Investments include amounts held to meet legally mandated annuity reserves of $28,033,838 and $27,234,303 as of June 30, 2005 and 2004, respectively, as required by the laws of the following states where certain individual donors reside: California, New Jersey and New York.

4. Accounts Receivable

The major components of receivables, net of reserve for doubtful accounts of $10,763,000 and $12,780,000 at June 30, 2005 and 2004, respectively, are as follows (in thousands):

	2005	2004
Sponsored research	$ 72,697	$ 55,176
Student	14,713	16,916
Trade	24,766	21,383
Investment income	4,735	4,190
Other	23,742	30,254
Total Receivables	$ 140,653	$ 127,919

5. Contributions Receivable

A summary of contributions receivable is as follows at June 30, 2005 and 2004 (in thousands):

	2005	2004
Unconditional promises expected to be collected in:		
Less than one year	$ 164,287	$ 121,064
One year to five years	153,909	148,470
Over five years	17,117	12,031
	335,313	281,565
Less: Discount and allowance for doubtful amounts	(77,537)	(60,786)
Contributions receivable, net	$ 257,776	$ 220,779

6. Other Assets

The major components of Other assets at June 30, 2005 and 2004, respectively, are as follows (in thousands):

	2005	2004
Goodwill	$ 33,184	$ 34,843
Defined benefit pension asset	22,285	20,283
Inventory	19,861	19,294
Prepaid expenses	20,266	16,649
Deferred financing fees	17,879	6,727
Unrecognized prior service costs	13,231	–
Other	11,640	7,864
	$ 138,346	$ 105,660

7. Plant, net of depreciation

The components of plant at June 30, 2005 and 2004 are as follows (in thousands):

	2005	2004
Land	$ 81,401	$ 91,515
Buildings	3,241,510	3,131,101
Contents	1,537,989	1,487,779
Construction-in-progress	194,163	137,134
	5,055,063	4,847,529
Less: accumulated depreciation	(2,294,223)	(2,130,866)
Plant, net of depreciation	$ 2,760,840	$ 2,716,663

The University recorded $207,550,000 and $196,367,000 of depreciation expense for the years ended June 30, 2005 and 2004, respectively. Rare books and other collectibles aggregating $20,776,000 at June 30, 2005 and $20,470,000 at June 30, 2004 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):

	2005	2004
Charitable gift annuities	$ 23,551	$ 23,052
Charitable remainder trusts	27,169	23,295
Pooled income funds	1,130	1,445
Total split-interest agreements	$ 51,850	$ 47,792

9. Debt Obligations

Debt obligations at June 30, 2005 and 2004 are as follows (in thousands):

	Maturity	Interest Rate at June 30, 2005	June 30, 2005	June 30, 2004
Academic Component:				
Fixed Rate Debt Obligations:				
Pennsylvania Higher Education				
Facility Authority (PHEFA)				
Series A of 2005 Revenue Bonds	09/2025	3.0% - 5.0%	$ 37,655	
Unamortized Premium			1,775	
Series B of 2005 Revenue Bonds	09/2025	5.0% - 5.25%	66,930	
Unamortized Premium			6,166	
Series A of 2002 Revenue Bonds	07/2008	3.5% - 5.0%	11,950	$ 14,590
Unamortized Premium			220	346
Series of 1998 Revenue Bonds	07/2038	4.5% - 5.5%	188,480	190,620
Unamortized Discount			(1,784)	(1,862)
Series A of 1995 Revenue Bonds	09/2006	7.0%	5,280	83,320
Series B of 1995 Revenue Bonds	09/2006	7.0%	2,380	37,495
Department of Education Bonds	03/2007	3.0%	126	190
Other Loans	Various	3.0% - 8.0%	12,999	13,439
Mortgage Notes	Various	8.0%		7,523
Total Fixed Rate Debt Obligations			332,177	345,661
Variable Rate Debt Obligations:				
PHEFA				
Series B of 2002 Revenue Bonds	07/2032	2.39%	48,900	49,625
Series of 1990 Revenue Bonds	12/2020	2.45%	6,500	6,500
Series of 1985 Revenue Bonds	12/20 15	2.45%	10,610	10,610
Quakertown General Authority				
Series of 2004	07/2034	2.13%	77,700	77,700
Washington County Authority				
Series of 2004	07/2034	2.25%	62,500	62,500
Other Loans	Various	2.7% - 3.9%	15,000	16,393
Total Variable Rate Debt Obligations			221,210	223,328
Total Academic Component Debt Obligations			553,387	568,989
UPHS:				
Fixed Rate Debt Obligations:				
PHEFA				
Series A of 2005 Revenue Bonds	08/2015	3.00% - 5.00%	273,280	
Unamortized Premium			21,182	
Series B of 2005 Revenue Bonds	08/2015	3.00% - 5.00%	86,555	
Unamortized Premium			2,444	
Series of 2002 Revenue Bonds	01/2024	7.5%	24,925	25,515
Series A of 1998 Revenue Bonds	01/2015	4.4% - 5.4%	38,750	38,750
Unamortized Premium			508	559
Series A and B of 1996 Revenue Bonds	01/2022	5.0% - 6.0%	16,500	361,295
Unamortized Discount				(2,198)
Series A of 1994 Revenue Bonds	01/2010	5.6% - 7.0%		28,120
Unamortized Premium				393
Notes Payable	10/2005	7.0%	4,441	7,861
Capital Leases	Various	4.6% - 5.9%	17,374	22,387
Total Fixed Rate Debt Obligations			$ 485,959	$ 482,682

	Maturity	Interest Rate at June 30, 2005	June 30, 2005	June 30, 2004
Variable Rate Debt Obligations:				
PHEFA				
Series C of 2005 Revenue Bonds	04/2024	2.4%	$ 103,675	
Series D of 2005 Revenue Bonds	04/2027	2.3%	92,400	
Series of 2004 Revenue Bonds	11/2010	3.4%	25,385	
Pennsylvania Hospital Series of 2004	01/2010	7.5%	89,235	
Series B of 1998 Revenue Bonds	01/2026	1.1%		$ 121,600
Series C of 1996 Revenue Bonds	01/2026	1.1%		80,000
Series B of 1994 Revenue Bonds	06/2024	1.1%		90,000
Pennsylvania Economic Development				
Financing Authority				
Series C of 1994 Revenue Bonds	09/2015	3.3%	8,000	8,583
Mortgage Notes	01/2007	1.5%		663
Total Variable Rate Debt Obligations			318,695	300,846
Total UPHS Debt Obligations			804,654	783,528
Total University Debt Obligations			$ 1,358,041	$ 1,352,517

The fair value of the University's debt obligations was $1,363,149,000 and $1,371,917,000 at June 30, 2005 and 2004, 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
2006	$ 52,967
2007	47,608
2008	50,245
2009	53,443
2010	47,791
Thereafter	1,075,476
Total Principal	1,327,530
Unamortized Premium/Discount	30,511
Total Debt	$ 1,358,041

Academic Component

On January 12, 2005, the Pennsylvania Higher Educational Facilities Authority ("PHEFA") issued Refunding Revenue Bonds, Series 2005A ("PHEFA 2005A Bonds") with an aggregate principal amount of $37,655,000. The proceeds were used to fund an escrow which will be used to refund $32,895,000 from the PHEFA Series B of 1995 Revenue Bonds ("Refunded 1995B Bonds"). The Refunded 1995B Bonds were legally defeased and, as such, are no longer included among the University's reported liabilities. The Refunded 1995B Bonds will be retired when they become callable on September 1, 2005 with escrow proceeds. PHEFA 1995B Bonds of $2,380,000 were not refunded and will be paid when due on September 1, 2005.

Interest on the PHEFA 2005A Bonds is fixed with coupons ranging between 3.00% and 5.00%. The PHEFA 2005A have serial maturities which are due in amounts ranging from $2,750,000 in 2006 to $5,155,000 in 2025. The bonds are callable after September 1, 2015 at a price equal to 100% of the principal amount plus accrued interest.

On June 7, 2005, PHEFA issued Refunding Revenue Bonds, Series 2005B ("PHEFA 2005B Bonds"), with an aggregate principal amount of $66,930,000. The proceeds were used to fund an escrow which will be used to refund $73,100,000 from the PHEFA Series A of 1995 Revenue Bonds ("Refunded 1995A Bonds"). The Refunded 1995A Bonds were legally defeased and, as such, are no longer included among the University's reported liabilities. The Refunded 1995A Bonds will be retired when they become callable on September 1, 2005. PHEFA 1995A Bonds of $5,280,000 were not refunded and will be paid when due on September 1, 2005.

Interest on the PHEFA 2005B Bonds is fixed with coupons ranging between 5.00% and 5.25%. The PHEFA 2005B have serial maturities which are due in amounts ranging from $4,510,000 in 2006 to $8,495,000 in 2015.

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.

UPHS

Pennsylvania Higher Education Facilities Authority Revenue Bonds

The PHEFA Revenue Bonds, exclusive of Series of 2004 and 2002, are secured by master notes issued under the UPHS 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 UPHS has sufficient cash flow to pay total operating expenses and to pay debt service for the fiscal year. In both 2005 and 2004, UPHS met its debt service coverage requirement under the MTI. Additionally, UPHS has pledged its gross revenues to secure its obligation under the MTI.

UPHS Series A of 2005 Bonds were issued on February 16, 2005 for the purpose of legally defeasing the non-current maturities of the Health Services Series A of 1996 bonds. The bonds mature in varying amounts ranging from $300,000 to $22,855,000, with a final maturity of $6,000,000 in 2023. The Bonds have stated interest rates that range from 3.00% to 5.00%. The Bonds are subject to optional redemption by the University as Obligated Group Agent on or after August 15, 2015 at a redemption price of 100% plus accrued interest. Payment of principal and interest on the 2009-2022 bond maturities is insured by Ambac Assurance Corporation.

UPHS Series B of 2005 Bonds were issued on February 16, 2005 for the purpose of funding various UPHS capital expenditures. The bonds mature in varying amounts ranging from $685,000 to $13,000,000, with a final maturity of $4,000,000 in 2018. The Bonds have stated interest rates that range from 3.00% to 5.00%. The Bonds are subject to optional redemption by the University as Obligated Group Agent on or after August 15, 2015 at a redemption price of 100% plus accrued interest. Payment of principal and interest on a portion of the 2008, 2009-2017 bond maturities is insured by Financial Guaranty Insurance Company.

UPHS Series C of 2005 Bonds were issued on April 6, 2005 for the purpose of legally defeasing the Health Services Series B of 1994 variable rate bonds. The bonds are subject to mandatory redemption in varying amounts ranging from $17,125,000 to $32,175,000 in 2024. Interest on the bonds is reset weekly through an auction process (2.40% at June 30, 2005). The Bonds are eligible to be changed to a fixed rate as elected by the University as Obligated Group Agent. The Bonds are subject to optional redemption by the University on any scheduled interest payment date or the first day of each rate period (as determined by the elected interest mode in effect) prior to their scheduled maturity at a redemption price of 100% plus accrued interest. Payment of principal and interest on the bonds is insured by Ambac Assurance Corporation.

UPHS Series D of 2005 Bonds were issued on April 6, 2005 for the purpose of legally defeasing the Health Services Series C of 1996 variable bonds. The bonds are subject to mandatory redemption in varying amounts ranging from $3,050,000 to $38,600,000, with a final maturity in 2027. Interest on the bonds is reset weekly by a remarketing agent (2.26% at June 30, 2005). The Bonds are eligible to be changed to a fixed rate as elected by the University as Obligated Group Agent. The Bonds are subject to optional redemption by the University on any scheduled interest payment date or the first day of each rate period (as determined by the elected interest mode in effect) prior to their scheduled maturity at a redemption price of 100% plus accrued interest. Payment of principal and interest on the bonds is insured by Financial Guaranty Insurance Company.

UPHS Series of 2004 Bonds were issued November 12, 2004 for the purpose of retiring the Series A of 1994 Bonds. The bonds mature in varying amounts ranging from $4,135,000 to $5,735,000 with a final maturity of $5,405,000 in 2010. The Bonds have stated interest rate of 3.35%.

The Series of 2004 Bonds, were issued on November 12, 2004, on behalf of Pennsylvania Hospital, for the purpose of legally defeasing the Health Services Series B of 1998 variable bonds. The bonds mature in varying amounts ranging from $2,110,000 to $13,380,000, with a final maturity of $10,655,000 in 2024. The bonds have a stated interest rate of 7.50%. The holder of the bonds will have the option to put them on January 1, 2010, as described in a put option agreement between HUP and CPUP and Merrill Lynch Portfolio Management, Inc. The 2004 Bonds are also guaranteed by HUP and CPUP, for which they receive a guarantee fee from the bondholder. The put option fee and the guarantee fee reduce the net cost of funds to 3.55%. UPHS entered into an interest rate exchange agreement with Merrill Lynch Capital Services in order to synthetically convert the Series of 2004 Bonds to a variable interest rate. The interest rate exchange agreement will terminate on January 1, 2010. This agreement was not entered into for trading or speculative purposes. Under the terms of the agreement, UPHS receives a fixed rate of 3.00% and pays a variable interest rate defined as the BMA index on the notional principal amount of the outstanding bonds.

10. Natural Classification of Expenditures

Expenses incurred were for (in thousands):

	Compensation	Student Aid	Depreciation	Interest	Other Operating	Total
June 30, 2004						
Instruction	$ 464,848	$ 46,719	$ 35,149	$ 2,466	$ 218,171	$ 767,353
Research	327,867	8,826	29,746	8,910	204,068	579,417
Hospitals and physician practices	1,080,572		87,954	33,239	875,984	2,077,749
Auxiliary enterprises	20,267		14,197	4,751	67,504	106,719
Other educational activities	77,801	7	5,508	731	34,909	118,956
Student services	23,051	111		154	14,537	37,853
Academic support	25,359		21,053	793	8,424	55,629
Management and general	127,618	12	8,074	968	29,289	165,961
Independent operations	5,705		5,869	2,616	45,413	59,603
Total	$ 2,153,088	$ 55,675	$ 207,550	$ 54,628	$ 1,498,299	$ 3,969,240
June 30, 2003	$ 2,047,477	$ 51,495	$ 196,367	$ 53,267	$ 1,367,539	$ 3,716,145

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, 2005 and 2004 totaling $48,161,000 and $43,341,000, respectively, is included in the accompanying Statement of Activities.

At June 30, 2005, future minimum lease payments under operating leases with remaining terms greater than one year were as follows (in thousands):

2006	$ 39,506
2007	35,194
2008	29,608
2009	25,725
2010	21,166
Thereafter	133,532
Total minimum lease payments	$ 284,731

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 $63,038,000 in 2005 and $58,458,000 in 2004.

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 noncontributory 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 $2,881,000 and $3,363,000 for 2005 and 2004, 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	
	2005	2004	2005	2004
Change in benefit obligation:				
Benefit obligation at beginning of fiscal year	$ 647,255	$ 646,895	$ 370,868	$ 323,682
Service cost	21,270	20,367	13,766	14,464
Interest cost	39,941	37,916	21,565	18,044
Plan participants' contributions	100	–	1,169	889
Amendments	–	–	–	2,211
Actuarial loss (gain)	164,834	(38,927)	41,673	27,057
Benefits paid	(20,067)	(18,996)	(15,803)	(15,479)
Benefit obligation at end of fiscal year	$ 853,333	$ 647,255	$ 433,238	$ 370,868
Change in plan assets:				
Fair value of plan assets at beginning of fiscal year	$ 602,527	$ 523,936	$ 95,523	$ 78,831
Actual return on plan assets	46,201	93,651	16,437	12,029
Employer contribution	25,473	3,835	19,734	19,253
Plan participants' contributions	100	101	1,169	889
Benefits paid	(20,067)	(18,996)	(15,803)	(15,479)
Fair value of plan assets at end of fiscal year	$ 654,234	$ 602,527	$ 117,060	$ 95,523
Reconciliation of funded status:				
Funded status	$ (199,099)	$ (44,728)	$ (316,178)	$ (275,345)
Unrecognized net actuarial loss	184,706	16,574	144,862	116,890
Unrecognized prior service cost (benefit)	13,231	14,876	(16,141)	(19,895)
Net amount recognized	$ (1,162)	$ (13,278)	$ (187,457)	$ (178,350)
Amounts recognized on balance sheet:				
Prepaid pension cost in other assets	$ 22,248	$ 20,283	$ –	$ –
Accrued retirement benefits	(23,410)	(33,561)	(187,457)	(178,350)
	$ (1,162)	$ (13,278)	$ (187,457)	$ (178,350)

Accrued retirement benefits includes $3,554,000 and $3,121,000 for faculty early retirement program at June 30, 2005 and 2004, respectively.

Accumulated benefit obligation for the University was $733,087,000 and $563,090,000 at June 30, 2005 and 2004, respectively.

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

	2005	2004
Projected benefit obligation	$ 682,801	$ 508,907
Accumulated benefit obligation	$ 576,147	$ 435,055
Fair value of plan assets	$ 493,847	$ 448,165

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	
	2005	2004	2005	2004
Service cost	$ 21,270	$ 20,367	$ 13,766	$ 14,464
Interest cost	39,941	37,916	21,565	18,044
Expected return on plan assets	(49,591)	(43,201)	(8,184)	(6,176)
Amortization of prior service cost	1,645	1,674	(3,754)	(4,007)
Amortization of transition (assets) obligation	–	(706)	–	–
Amortization of net (gain) loss	93	3,5 28	4,990	4,628
Net periodic cost	$ 13,358	$ 19,578	$ 28,383	$ 26,953

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, 2005 and 2004 (in thousands):

	2005	2004
Increase (decrease) in minimum liability included as nonoperating income	$ 43,432	$ (2,441)

Assumptions

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

	2005	2004
Discount Rate	5.17%	6.25%
Salary Increase	3.50 - 4.75%	3.50 - 4.75%
Measurement Date	June 30, 2005	June 30, 2004

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

	2005	2004
Discount Rate	6.25%	6.00%
Salary Increase	3.50 - 4.75%	3.50 - 4.75%
Expected Return on Plan Assets	8.38%	8.38%
Measurement Date	June 30, 2004	June 30, 2003

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:

	2005	2004
Initial Trend Rate	11.0%	11.5%
Ultimate Trend Rate	5.0%	5.0%
Fiscal Year End that Ultimate Trend Rate is Reached	2013	2014

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	$ 6,952	$ (5,513)
Effect on accumulated postretirement benefit obligation	$ 62,938	$ (51,455)

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 40% and international equities comprised 28% of plan assets at June 30, 2005. The average quality of debt securities at June 30, 2005 was AAA with an effective duration of 4.17 years. The target and actual allocation for plan assets is as follows:

	Target	2005	2004
Equity securities	70.0%	68.0%	71.0%
Debt securities	30.0%	32.0%	29.0%
	100.0%	100.0%	100.0%

Cash Flows

The University's expected contributions for the year ending June 30, 2006 total $41,715,000.

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,		
2006	$ 22,544	$ 17,532
2007	23,575	18,872
2008	25,072	20,322
2009	26,919	21,483
2010	29,112	22,800
2011 and beyond	193,606	128,428

On December 8, 2003, President Bush signed into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 ("the Act"). The Act expanded Medicare to include, for the first time, coverage for prescription drugs. This new coverage is generally effective January 1, 2006.

The University's retiree medical program already provides prescription drug coverage for retirees over age 65 that is comparable to the benefit provided under Medicare. As long as the retirees remain in the University's medical plan rather than signing up for the new Medicare prescription drug coverage, Medicare will provide a subsidy directly to the University.

This legislation has therefore reduced the University's share of the obligations for future retiree medical benefits. As a result of reflecting the legislation, the Accumulated Postretirement Benefit Obligation (APBO) as of June 30, 2005 has been reduced by $27,101,000. By treating the subsidy as an actuarial gain, the University's net periodic postretirement benefit expense for the fiscal year ending June 30, 2005 has been reduced by $4,789,000.

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 surcharge s, 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, 2005.

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.

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

	June 30, 2005		June 30, 2004	
	Amount Gauranteed	Recognized Liability	Amount Gauranteed	Recognized Liability
Mortgage Loans	$ 32,973	$ –	$ 32,448	$ –
Student Loans	65,799	6,357	141,120	11,415
Other	8,522	388	8,955	423
	$ 107,294	$ 6,745	$ 182,523	$ 11,838

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, $20,818,000 and $20,171,000 at June 30, 2005 and 2004, 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 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. In November 2004, certain graduate student loan guarantees were modified and an escrow was established to provide funding for future defaults. These modifications reduced the total amount guaranteed by the University by $70,292,000 and reduced the recognized liability by $2,500,000. Of the amount guaranteed, $15,216,000 and $30,165,000 at June 30, 2005 and 2004, 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, $4,854,000 at June 30, 2005 and $5,194,000 at June 30, 2004, 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, 2005, approximately $197,966,000 has been committed by the University.

notes to financial statements

15. Subsequent Events

On August 18, 2005, PHEFA issued Revenue Bonds, Series 2005C ("PHEFA 2005C Bonds"), with an aggregate principal amount of $141,620,000. The proceeds were used to fund a construction project of approximately $70,000,000 and to fund an escrow which will be used to refund $72,640,000 from the PHEFA Series of 1998 Revenue Bonds ("Refunded 1998 Bonds"). The Refunded 1998 Bonds were legally defeased and, as such, will no longer be included among the University's reported liabilities after August 18, 2005. The Refunded 1998 Bonds will be retired when they become callable on July 15, 2008. $113,600,000 of the PHEFA 1998 Bonds were not refunded and will be paid as they become due.

The note payable to the Redevelopment Authority of the City of Philadelphia, with an outstanding principal balance of $7,336,247 was satisfied on August 26, 2005.

trustees

as of June 30, 2005

statutory officers

as of June 30, 2005

President
Dr. Amy Gutmann

Provost, Interim
Dr. Peter Conn

Executive Vice President
Mr. Craig R. Carnaroli

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

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

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 Budget and Management Analysis
Ms. Bonnie Gibson

Vice President and Chief of Staff
Ms. Joann Mitchell

Vice President for Communications
Ms. Lori N. Doyle

Vice President for Development and Alumni Relations
Mr. John H. Zeller

Vice President for Finance and Treasurer
Mr. Scott R. Douglass

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

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

Vice President for Information Systems and Computing
Ms. Robin H. Beck

Vice President for Public Safety
Ms. Maureen Rush

Secretary of the University
Ms. Leslie Laird Kruhly

Comptroller
Mr. John Horn