



ANNUAL REPORT



1997-98





TABLE OF

CONTENTS

Message from the President	<i>1</i>
Message from the Executive Vice President	<i>13</i>
Message from the Executive Vice President and CEO, University of Pennsylvania Health System	<i>19</i>
Message from the Vice President for Finance	<i>27</i>
Financial Section	<i>37</i>
A Five-Year Review of Investments	<i>37</i>
Endowment	<i>38</i>
Associated Investments Fund	<i>29</i>
Management Responsibility for Financial Statements	<i>40</i>
Report of Independent Accountants	<i>41</i>
Statement of Financial Position	<i>42</i>
Statement of Activities	<i>43</i>
Statement of Cash Flows	<i>44</i>
Notes to Financial Statements	<i>45</i>
Trustees of the University of Pennsylvania	<i>46</i>
Statutory Officers of the University of Pennsylvania	<i>47</i>



Judith Rodin, *President*

MESSAGE

FROM THE PRESIDENT

One of Penn's greatest blessings is its single, unified campus. Many believe it is one of America's most beautiful urban enclaves, allowing each of Penn's twelve outstanding schools to stand within a few blocks of all the others. Paradoxically, as technology has made global "distance learning" a remarkable reality, one in which Penn is an active and successful participant, the ability of a neurologist in our School of Medicine to walk across the street to collaborate with a distinguished psychologist in our School of Arts and Sciences seems more precious than ever. This proximity is one of the attractions — almost unique among our peers — that has made Penn so successful in assembling a world-class faculty. The opportunity at Penn for the dialogues of scholarship is unsurpassed.

It is the rage today for universities to boast of their multidisciplinary character. At Penn that character is an established fact. Encouraged by the happy circumstances of campus geography and by the core goals of the *Agenda for Excellence*, Penn's strategic plan, our faculty are breaking through disciplinary boundaries at a rapid pace, creating new forms and categories of knowledge and expanding the minds of our students. The nature of her research causes the psychologist I just mentioned to confer more routinely with colleagues in Medicine than in Arts and Sciences; a Wharton School economist collaborates with a Law School game theorist on a regular basis; the Deans of our School of Engineering and Applied Science, Graduate School of Fine Arts and Annenberg School for Communication have impromptu conversations on Locust Walk in which they share observations on their new joint undergraduate program in digital media design.

In this message I will report on the great progress made during Fiscal Year 1998 in the six University-wide academic priorities established in the *Agenda for Excellence*. I described these six priority areas in detail in Penn's last two annual reports: each is avowedly multidisciplinary, each is an important strategic





statement for the University, each unites theory and practice as Penn has done throughout its history, and each is being advanced by some of Penn's most brilliant faculty. Briefly stated, the priorities are:

- Life Sciences, Technology, and Policy
- American and Comparative Democratic and Legal Institutions
- Management, Leadership, and Organizations
- The Humanities — Meaning in the 21st Century
- The Urban Agenda — Penn in Philadelphia
- Information Science, Technology, and Society

Premier universities in the 21st Century will combine excellent undergraduate colleges with outstanding capstone graduate and professional programs. With a disciplined focus on our academic priorities, Penn will excel in this milieu. First, Penn will have a superb program of undergraduate education, newly invigorated by our comprehensive College House system, which saw its inaugural class in September 1998. Second, Penn's undergraduate program will be united on our campus with leading centers of graduate and professional excellence that will be enhanced by these six priorities. Students at every level will have unsurpassed opportunities to combine educational elements from all of our schools because of the strong multidisciplinary links among them.

Following my report on the six academic priorities will be complementary messages from Penn's Executive Vice President, the Executive Vice President and CEO of the Health System, and Vice President for Finance. Together they detail the University's impressive success in meeting a number of other vital goals from the *Agenda for Excellence* during Fiscal Year 1998. In particular, they report on exciting improvements in the quality of life on campus, great progress in several initiatives to revitalize Penn's University City neighborhood, continuing success in administrative restructuring, outstanding financial performance and fundraising results, and extraordinary growth in sponsored research across the institution.

LIFE SCIENCES, TECHNOLOGY, AND POLICY

Fundamental scientific research in the life sciences is vital to the generation of new knowledge that will guide our future. As the University recognized in the development of the *Agenda for Excellence*, Penn has excelled in the life sciences in recent decades, but a rigorous strategic focus and substantial investments will be required in times ahead if we are to continue to enhance our research capacity. Stated as an academic priority, Life Sciences, Technology, and Policy will build on the present strengths and plans of Penn's biomedical schools — Medical, Nursing, Dental and Veterinary — as well as on particular strengths and plans of the School of Arts and Sciences, the School of Engineering and Applied Science, and the Wharton School. Our success will produce lasting benefits for the entire University, including a variety of opportunities for new undergraduate research programs.

Fiscal Year 1998 was highlighted by important work in a new field of emphasis in this priority area: cognitive neuroscience. Located at the intersection of a number of dynamic disciplines,



including biology, neurology, and psychology, this emerging field promises extraordinary revelations about the human mind and its workings, and it offers great opportunities for leadership from Penn. Significant resources will be committed to the development of cognitive neuroscience over the next five years, and long-term planning is well underway by a cross-school, multidisciplinary faculty planning committee chaired by Dr. Robert Barchi, who will assume the post of University Provost in Fiscal Year 1999, and who is the David Mahoney Professor and Chair of Neuroscience and Neurology in our School of Medicine.

Other areas in the life sciences that received attention this year and will continue to be emphasized include genetics and genomics; simulation and molecular design; mind, brain and behavior; and developmental biology. All of these have grown from, and will continue to rely on, extensive cross-school collaboration and interaction. It is also evident that continuing advances in these and other biomedical sciences will be heavily dependent on simultaneous improvements in the information sciences — an important, complementary University academic priority.

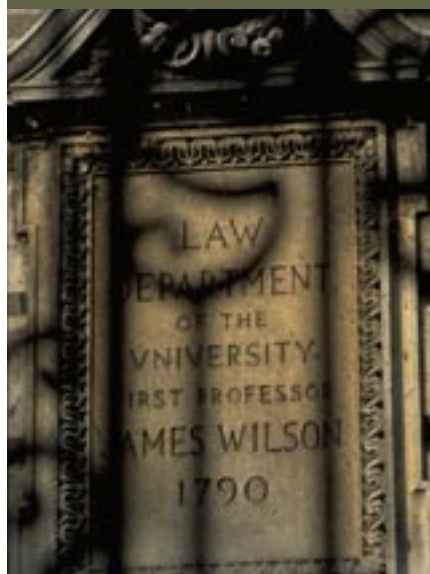
One of Penn's signal objectives is to accelerate the translation of basic science discoveries to the clinic — to make the fruits of these discoveries available to society as quickly as possible and, thereby, to improve human health. A wonderful new location where this translation will take place is the Roy & Diana Vagelos Laboratories of the Institute for Advanced Science and Technology. Made possible by a generous gift from our Board Chair and his wife, these state-of-the-art laboratories opened to great applause in Fiscal Year 1998, with boundless potential for world-changing basic research in chemistry, engineering, and medicine.

AMERICAN AND COMPARATIVE DEMOCRATIC AND LEGAL INSTITUTIONS

It is increasingly clear, as we said two years ago in announcing this priority, that we must come to a different, deeper understanding of the institutions of democracy and their role in preserving civilized society. Amid the constant political tumult of the day, both domestic and global, the questions we posed are ever more urgent: What are the abiding lessons of American jurisprudence, politics, and history that can be successfully “exported”? What is the intrinsic relationship between free economic markets and democracy? How should the “Americanization” of the globe affect our view of ourselves?

Our goal is for the University to play an active role in public discourse on the subject of democracy both within America and abroad. As one step toward that end, in Fiscal Year 1998 the University enhanced its role as the academic partner of the National Constitution Center and helped the Center secure first-stage federal funding for construction of an interactive multi-media museum on the Constitution at Philadelphia's Independence Mall.

On campus, we have continued to pursue transforming appointments in Penn's Political Science Department through resource commitments and the recruitment of leading Americanist scholars. During the course of the year, a University-wide task force, including faculty and deans from the



School of Arts and Sciences, the Wharton School, the Law School, and the Annenberg School, identified and began active recruitment of five nationally distinguished scholars who could dramatically enhance the University's commitment to ground-breaking scholarship in this area.

MANAGEMENT, LEADERSHIP, AND ORGANIZATIONS

The Wharton School has continued to lead the way in answering the most provocative questions about private sector management in the 21st Century: questions about the intersection of business and new technologies, the increasing diversity of employees and consumer populations, the globalization of financial markets, and the productivity of burgeoning "virtual offices." There has never been a greater need for clear vision, for probing research into the changing forms of organizations and the management they require, and for leadership. The mutually supporting relationships among its schools make Penn exceptionally well-positioned to meet this need. One good example this year was a partnership among Wharton, Penn's health sciences schools, the Law School, and the Annenberg School to address proliferating questions about the future management and organization of health-care delivery systems.

Simultaneously, in the public sector, a growing need for sophisticated management expertise is increasingly apparent. Social servants in traditional public agencies are experiencing their own management crises in the wake of agency privatization. Faculty in our Schools of Law, Education, Social Work, Arts and Sciences, and Fine Arts offer, in combination, extraordinary expertise on today's hard questions of management in the public sector — questions about the financing and delivery of social services in a free market economy, the application of outcome measures to social service agencies, the growth of "public-private partnerships" and the like. Efforts to marshal this expertise in effective ways began in earnest this year and will continue in the years ahead.

THE HUMANITIES - MEANING IN THE 21ST CENTURY

One of this year's most important achievements was the creation of the Penn Humanities Forum, which addresses fundamental changes in the nature of humanistic research and general culture. The Forum, in the School of Arts and Sciences, is directed by Dr. Wendy Steiner, the Richard L. Fisher Professor and Chair of the Department of English. As Dr. Steiner put it in a recent introduction to the Forum:

"Humanistic scholars are faced with a new imperative: to explain how ideas and arts interact in our personal and civic lives, and why they matter. . . . Responsive to this situation, the Forum aims at nothing less than a shift in the 'culture of the humanities' at Penn. It will promote this change through three mechanisms: an interdisciplinary research center, an administrative structure encouraging cooperation across departments and schools, and a liaison between Penn humanists and the City of Philadelphia. . . . Our think tank will be both a sponge and a sieve. It will promote a model of humanistic exploration in which the



University and the City are respectful partners in a conversation extending across the Greater Philadelphia area.

“... The Forum will thus have many beneficiaries. But perhaps most fundamentally, it will provide a situation in which humanities professors and students can put their ideas and values to work. Sharing their research in a rich conversation, learning from those outside their field, translating the life of the mind into benefit for the community: these are possibilities that would turn Penn from one of the strongest humanities groups in the country into a pathbreaking humanistic force. There is no humanities center set up to do what this one will, for the Forum will be reinventing the very meaning of academic humanism.”

THE URBAN AGENDA - PENN IN PHILADELPHIA

Few, if any, universities are better placed than Penn to contribute to the rigorous study of seminal urban issues. Virtually all of our schools have some degree of interest, and the interest is keen in several: the Graduate School of Fine Arts, the Graduate School of Education, the School of Social Work, the School of Arts and Sciences, the School of Nursing, and the Wharton School. Greater mobilization of Penn's broad intellectual resources will lead to new models for urban revival.

A faculty task force chaired by Graduate School of Education Dean Susan Fuhrman met throughout the year to refine an Urban Agenda for Penn in the 21st Century. A wide range of interwoven and compelling issues was considered by the task force: from race and ethnicity to transportation; from structures of municipal finance to strategies for community revitalization; from the character of urban institutions to the effects on individuals of politics and citizenship.

Penn's goal is to become the nation's premier academic institution in teaching and conducting research on urban affairs. To achieve this, the task force emphasized the need for significant institutional and financial commitments, and Penn is prepared to make them. They are likely to include the establishment of an urban research institute with associated distinguished fellows and publications, the realignment of various urban-related academic programs, and the appointment of several distinguished faculty members whose work will deepen our research agenda. Consultation and planning on these prospects will continue this year.

INFORMATION SCIENCE, TECHNOLOGY, AND SOCIETY

Information science and technology are transforming the world, our lives, and our understanding of who we are at a pace that grows faster every day. Penn must and will lead in fields related to information science and its impact on society. We must be creative in fundamental information science and technology research; we must also grapple hard with growing issues concerning the societal impact of information technology. Among these are questions about how to harness the power of the computer to understand language and the workings of the mind. Penn is also a natural leader in the use of information technologies to foster learning and redefine the ways in which universities will serve society in the coming decades.



To advance this academic priority, we convened an information technology working group comprised of some of Penn's most prescient faculty and administrators. The working group was asked to consider carefully the core missions of the University and attempt to identify those aspects of computer and information science — both as a field and as a department — in which Penn must excel in the coming decades.

One of the most important outcomes of the working group's efforts this year was its call for a dramatically expanded Computer and Information Science Department. The University responded quickly: At the end of the year a new building was being planned to house our Computer and Information Science faculty, and significant resources were allocated for strategic new faculty appointments. Clearly the future of CIS will be critical to excellence in research and education across the University. This investment will support that future.

LIVING INTERSECTS WITH LEARNING

As a final note, I want to recognize how every corner of our campus and every hour of the day are filled with activities of an extraordinary collegiate community. A newly vital part of this lively picture is the University's innovative comprehensive College House system, which will form the heart of the Penn undergraduate experience.

By Fall 1998, each of our residence halls will have been transformed into one of twelve College Houses, where undergraduates, faculty, staff, and graduate students will form distinct, shared communities within the larger context of Penn's campus. Modeled after pilot communities that have met with great success within our residential system, each of the twelve College Houses will have specialized programming and common advising and support for academic and co-curricular activities. Students will have opportunities for daily contact with a number of Penn's distinguished faculty and scholars who will live in residence.

Each College House will provide a point of contact for its members to Penn's growing system of academic support services called "The Wheel." The Wheel will provide *residentially based* support to students in mathematics, information technology and computing, writing, research, and library resources. Services will expand to include languages, the arts, and other core academic areas. Using both new technology and the supportive residential environment of the College Houses, the Wheel will deliver its services when and where students need them — typically in one's room and often late at night, making our campus a truly round-the-clock academic experience.



Our academic priorities and our burgeoning residential system signal an even stronger and brighter institution at the vanguard of higher learning. Penn, with its unified campus, is in a premier position to exemplify excellence in higher education. In the years to come, the unsurpassed connectedness among our distinct and distinctive schools and disciplines will continue to be our signature.





MESSAGE

FROM THE EXECUTIVE VICE PRESIDENT

BACKGROUND

The University's administrative initiatives continue to be guided by our strategic plan, the *Agenda for Excellence*. Our goals have been to enhance significantly the quality of life on campus and in our neighboring communities, and to manage aggressively our administrative activities to improve the quality of services, reduce and contain costs, identify new revenue generating activities, and identify and manage risk.

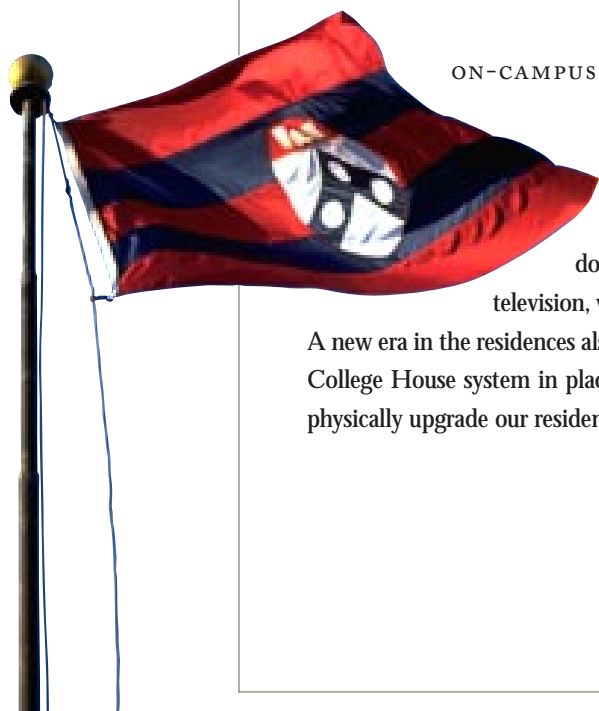
QUALITY OF LIFE

Fiscal Year 1998 saw significant progress in our efforts to enhance the quality of life for our students, faculty, and staff. Many of the initiatives of the past year involved planning for major investments in the campus infrastructure, including residence halls, recreational facilities, and dining halls. Relative to our neighborhood, a significant accomplishment was the establishment of the University City District (UCD), a collaborative effort of the institutions and communities of University City to create a safe, clean, and vibrant neighborhood. Penn also continued its aggressive revitalization efforts in the neighboring communities by launching new initiatives such as the enhanced mortgage program and UC Brite.

ON-CAMPUS QUALITY OF LIFE INITIATIVES

- Residential Enhancements: Fiscal Year 1998 saw the completion of one major residential initiative and the beginning of another. ResNet, the project to wire every dormitory room for high speed internet connections and cable television, was completed after several years of planning and installation.

A new era in the residences also began with the planning for the College Houses. With the College House system in place, Penn will have a blueprint to guide major investments to physically upgrade our residential facilities.





- **Recreational Facilities Renewal:** The firm of Brailsford & Dunleavy was hired to evaluate Penn's existing athletic and recreational facilities and to help in prioritizing future investments. In anticipation of the study's results, the Ringe Squash Courts were rehabilitated and the White Training House renovated, and plans were put in place to build a state-of-the-art fitness center in the Gimbel Gymnasium.
- **Retail Improvements:** The greatly expanded and enhanced Penn Bookstore and Computer Connection opened in Sansom Common, ready for the new academic year. The Bookstore, now operated by Barnes & Noble, is already considered by many to be the finest university bookstore in the country. As part of the Sansom Common project, new restaurants and stores were attracted to 36th Street and up and down Walnut Street. On 40th Street, the Walnut Mall was renovated and a flagship Eat at Joe's diner was added in anticipation of the Hamilton Square project.
- **Safety and Security:** Facilities Services completed Phases I and II of the Campus Lighting plan, which serves to both illuminate architecturally significant buildings and to enhance walkway lights in order to increase safety. Additionally, a number of major security technology installations were completed, and new "blue light" phones were installed throughout the campus. The Division of Public Safety, formerly operating out of four buildings around campus, is now consolidated in a new state-of-the-art facility at 40th and Chestnut streets. This new headquarters will not only anchor the 40th Street corridor, but also provide a more effective environment for coordinating the University Police Department and our extensive Security Services operation. Collectively, these initiatives have helped significantly reduce the occurrence of crime, both on and off campus, over the past year.

OFF-CAMPUS QUALITY OF LIFE INITIATIVES

- **Clean and Safe Neighborhoods:** The University City District became operational with 40 Safety Ambassadors patrolling the streets of University City on foot and by bicycle, and 30 uniformed cleaning crews providing sidewalk cleaning services daily. The majority of the cleaning employees are residents of West Philadelphia and graduates of a rigorous welfare-to-work program. In addition, the University brought the UC Brite program to completion with the installation of over 2,500 light fixtures in the neighboring community.
- **Commercial Development:** The University was successful in convincing the Philadelphia City Council to approve an ordinance regulating street vending in University City. Vending has long discouraged commercial growth in area retail corridors and has given the campus an unkempt appearance on many of its major streets. The new regulation has preserved vending in select areas around the Penn campus while ensuring that operators comply with local laws aimed at improving safety and cleanliness standards.



- **Encouraging Home Ownership:** In March 1998, Penn announced the Enhanced Mortgage Program, a cash incentive that enables eligible employees who purchase homes in University City to receive either \$3,000 per year for seven years or a one-time payment of \$15,000 on a property that is their principal place of residence. In addition, existing homeowners who are Penn employees are eligible for a \$7,500 match on home improvement expenses. The goals of these programs are to encourage home ownership and to preserve the beauty and historic character of the University City neighborhood. Through the first four months of the program, 35 faculty and staff were able to purchase homes and over 200 inquiries about these programs were received.
- **Supporting Local Businesses:** The University of Pennsylvania's "Buy West Philadelphia" initiative has sought to leverage Penn's considerable buying power to benefit businesses in West Philadelphia. Penn purchased nearly \$42 million worth of goods and services from West Philadelphia businesses during Fiscal Year 1998, an increase of almost \$17 million from the previous year. In addition, the Sansom Common project achieved record goals for participation by minority and women-owned businesses with over 40%, or \$13.3 million, of the total contract awards made to such firms. On the same project, minorities and women have worked nearly 35% of the total construction hours through June 1998, and 111 West Philadelphia residents have worked on the construction job site.

ADMINISTRATIVE RESTRUCTURING

As we finish the third year of our five year administrative restructuring program, Penn has made great progress toward reducing and containing the cost of administration while generating new revenue through entrepreneurial business ventures. As a result of these initiatives, we have been able to provide additional support for the University's academic programs and physical infrastructure. Fiscal Year 1998 saw much progress on the enhancement of the quality of services we provide to the Penn community.

- **Facilities Services Reorganization:** In a landmark deal for higher education, Trammell Crow Company has been hired by the University to manage our physical plant and project management functions, positioning the University to achieve significant service improvement and cost efficiency. The incentive-based contract was designed to introduce private-sector discipline to the management of our physical plant and the construction and renovation of our facilities.
- **Food Services Master Plan:** After an extensive process which examined all of our food service programs, we selected Bon Appetit, a San Francisco-based contract food service company with a national reputation for creativity, to operate all food services in the Perelman Quad, to serve as the primary University caterer, and to provide hands-on advice and best practices to the University Dining Services management. The result of this partnership will be an excellent array of food options, both on and off campus, for the entire Penn community.



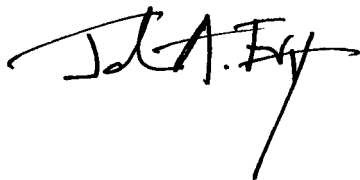
- Penn Card/Penn Cash: The new Penn Card was launched, with the addition of “Penn Cash”. “Penn Cash” allows students to purchase goods and services in many University City and campus establishments without having to carry large amounts of cash. This new Penn Card feature was designed in response to student interest in a universal debit card that could be used both on and off campus. The University also gave MBNA America the right to market the Penn Visa Card. As part of this arrangement, MBNA made a \$6 million contribution to the University, \$4 million of which funded the Campus Lighting program.

CONCLUSION

Penn has taken, and will continue to take, aggressive steps to improve the quality and cost effectiveness of the administrative services we provide. Beyond establishing a sound management infrastructure for the University, we will continue to make strenuous efforts to ensure that the quality of life will improve both on our campus and in our surrounding neighborhoods.

As we look to Fiscal Year 1999, we will continue to identify every opportunity to reduce and contain costs, to leverage our buying power, to enter into external partnerships that strengthen our service delivery capacity, to generate new sources of revenue, and to improve the surroundings in which our students, faculty, staff, and community work and live. Our goal is nothing less than being the best managed University in the country.

Finally, we note that none of our ambitious goals could have been achieved if not for the hard work and dedication of our talented and devoted staff. Sadly, in April, we lost one of our most distinguished colleagues and friends, Steve Murray. As Vice President of Business Services, he guided many of our most important efforts including some which reached fruition this year, specifically the residential renewal strategy, the food services master plan, and the design and construction of the new Penn Bookstore. To commemorate his contribution to the University and his great impact on the lives and careers of his colleagues, we have named the new street at Sansom Common “Steve Murray’s Way”. This will serve as a lasting tribute to a man whose impact on the University will be felt for years to come.





MESSAGE

FROM THE EXECUTIVE VICE PRESIDENT AND CEO
UNIVERSITY OF PENNSYLVANIA HEALTH SYSTEM

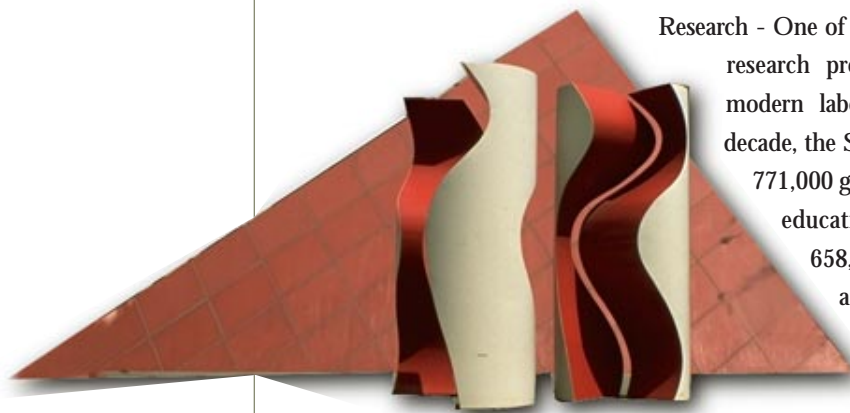
BACKGROUND

When the Trustees established the University of Pennsylvania Health System (UPHS) in 1993, their goal was to create a fully integrated academic health system, essentially the first of its kind, to support our three academic missions - education, research, and patient care. Five years into our aggressive implementation strategy, I would like to bring you up to date on where we stand - and where we are headed.

FULFILLING OUR ACADEMIC MISSIONS

Education - In 1997, the University of Pennsylvania School of Medicine established Curriculum 2000™, a completely transformed medical education approach to prepare students to become 21st century leaders in medicine and science, and we are now implementing this path-breaking program. Taking advantage of new Web-based technologies, the School has also developed Virtual Curriculum 2000, which has allowed students to view lectures and access other institutional materials through the internet - no other medical school in the country has developed such an advanced distance learning program to date. For these and other initiatives, the School has achieved national recognition, climbing to 4th place in the 1998 *U.S. News & World Report* ranking of medical schools in the United States.

Research - One of the keys to developing outstanding research programs is providing our faculty modern laboratory space. During the past decade, the School of Medicine has constructed 771,000 gross square feet of new research and education space and has renovated 658,000 gross square feet for research and education. In April 1999, as part of this decade-long initiative, Biomedical Research Building II/III - with 384,000 gross





square feet of new space - is scheduled to open. Taken together with other major initiatives, e.g., the establishment of 11 major multidisciplinary programs in the 1990's such as the Institute for Human Gene Therapy, the Institute for Medicine and Engineering, the Center for Bioethics, and, in 1998, the AIDS and HIV Research Center, the School has moved to 3rd place in total research funding from the National Institutes of Health (NIH), with \$175 million in NIH grants for Fiscal Year 1997 - this total is the highest in Pennsylvania and more than all other Delaware Valley academic medical centers combined. To achieve this, the School has demonstrated the highest average annual growth rate in NIH research funding among the top 10 NIH institutions during the past decade and has achieved the top absolute increase in NIH research funding this decade among all 125 schools of medicine in the United States, with 33% more growth than the number two school in the nation. Looking forward, the establishment of The Leonard and Madlyn Abramson Family Cancer Research Institute at the University of Pennsylvania Cancer Center and the recent recruitment of its Scientific Director hold great future promise for cancer research at Penn.

Clinical - In 1998, the Hospital of the University of Pennsylvania achieved its first-ever Accreditation with Commendation from the Joint Commission on the Accreditation of Healthcare Organizations (JCAHO) and was ranked 11th in the nation among 7,000 hospitals surveyed in the annual *U.S. News & World Report's* America's Best Hospitals listing. Also in 1998, the UPHS won the National Quality Health Care Award, presented by the National Committee for Quality Health Care. Penn is the first and only health care system on the East Coast to receive this prestigious award, which recognizes our commitment to quality at every level of the Health System. In addition, the UPHS won the eighth annual Excellence in Healthcare Award, a national award recognizing outstanding quality, sponsored by *Modern Healthcare* magazine and MMI Companies, Inc. Finally, the Hospital of the University of Pennsylvania was the 1998 recipient of the Ernest A. Codman Award from the Joint Commission for Accreditation of Healthcare Organizations (JCAHO), which recognizes an organization's institution-wide commitment to quality. Taken together, these three major national health care awards represent the "Triple Crown" in health care quality for 1998.

I am also pleased to report that our Health System's inpatient admissions and outpatient volume continue to grow. Through the recruitment of several noteworthy physician groups - particularly in cardiology and internal medicine at Presbyterian, in neurology, hematology/oncology, and orthopaedics at Pennsylvania Hospital, and in cardiology at HUP - we have positioned ourselves well for the future. In July, Phoenixville Hospital will occupy Penn Medicine at Limerick, a medical office building that will further extend our regional presence.

IMPLEMENTATION OF A FULLY INTEGRATED ACADEMIC HEALTH SYSTEM

Now comprising 4 owned hospitals, 13 hospital affiliates, 12 educational affiliates, a primary care physician network, and home care, hospice, and nursing home services, UPHS provides a full range of clinical services across the entire continuum of care to residents of the



Philadelphia region, with an estimated 20 percent share of the Delaware Valley health care market. Three new affiliates joined us in 1998: Shore Memorial Health System (Somers Point, N.J.); St. Luke's Hospital and Health Network (Allentown/Bethlehem, Pa.); and Catholic Health Initiatives-East (with hospitals in Lancaster, Langhorne, Philadelphia, and Reading). Essentially all of the critical components to our Health System are now in place; our current focus is on impeccable implementation. We believe we are well on track to improving the way health care is delivered in this country and in demonstrating to the nation the added value of a fully-integrated academic health system.

Health and Disease Management - One of the Health System's major long-term strategies is the implementation of the Health and Disease Management program, a best-practices approach for providing patients who suffer from chronic diseases such as asthma, diabetes, and congestive heart failure with comprehensive, coordinated care to achieve least practice variation, best outcomes, and best value. Since its introduction, this program has become the largest of its kind in the world and, we believe, the best in the nation. It is also the only such program designed and implemented exclusively by providers of care. To date, thousands of patients have been enrolled in 24 disease-management protocols involving over 300 physicians at 70 sites throughout UPHS. Moving beyond the Health System, UPHS recently entered into a licensing agreement with Volunteer Hospitals of America (VHA), a nationwide network of more than 1,750 leading community-owned health-care organizations and their physicians to offer VHA members on-line access to select clinical protocols from this program throughout the United States.

HEALTHCARE ENVIRONMENT

This is a period of great change in health care, particularly in the Philadelphia region. Hospitals and health systems are grappling with ongoing rate reductions and denials of coverage from managed care companies, a surplus of hospital beds locally, reduced reimbursements from Medicare, and more restrictive Medicaid eligibility requirements (Pennsylvania Act 35) that have increased the numbers of charity care patients. Indeed, the severity of these financial pressures recently caused a major competitor to file for bankruptcy and propose the sale of its local hospitals.

A SUMMARY AND A THANK YOU

All of the success we have achieved this past year, and in earlier years, is due to our superb faculty, outstanding academic leadership, and to the others in our organization who give their best each and every day. On behalf of the University, I offer my personal thanks to each who has contributed so much to creating the future of medicine at the University of Pennsylvania Health System.

William N. Keeney



MESSAGE

FROM THE VICE PRESIDENT FOR FINANCE

Fiscal Year 1998 was a fast-paced and challenging year for the University as competitive market forces continued to increase pressure on both our academic and health care enterprises. However, Fiscal Year 1998 was also a year in which the University made significant progress toward the achievement of the goals of our long-term strategic plan, the *Agenda for Excellence*. The University saw its national prominence enhanced, with recognition from numerous notable surveys and publications.

During Fiscal Year 1998, the University increased its net assets over 9%, primarily as a result of successful fund raising efforts and a strong equity market. This was despite a net loss from operations from the patient care activities of our hospitals and physician practices. The University continued the trend of the last several years with a double-digit increase in funding for research. The School of Medicine achieved particular success, moving up to the number three ranking in overall funding from the National Institutes of Health (NIH).

We continued to invest in our academic and physical infrastructure while seeking opportunities to reduce costs, enhance revenues, and improve service. We made substantial progress on several key academic and quality of life capital projects. Within the Division of Finance, we completed several important restructuring initiatives. We opened a redesigned and renovated Student Financial Services Center, restructured the Office of Investments, reorganized and upgraded administrative support for sponsored programs, and completed the planning for an upgrade to our financial management information system.





FISCAL YEAR 1998 PERFORMANCE HIGHLIGHTS

During Fiscal Year 1998, the University increased its net assets by \$367 million, to a total of over \$4.5 billion, of which \$2.3 billion was unrestricted. The increase was mainly attributable to non-operating activities: realized and unrealized gains on investments of about \$222 million, \$51 million in investment income reinvested into principal and \$171 million in contributions received for capital projects and endowment. Offsetting these non-operating increases was a net loss from operations of \$34.4 million. The operating loss was comprised of a loss from operations, after consolidation and elimination of inter-entity transactions incurred by the Health Services Component, offset by an excess of revenue over expenses from operations generated by the rest of the University.

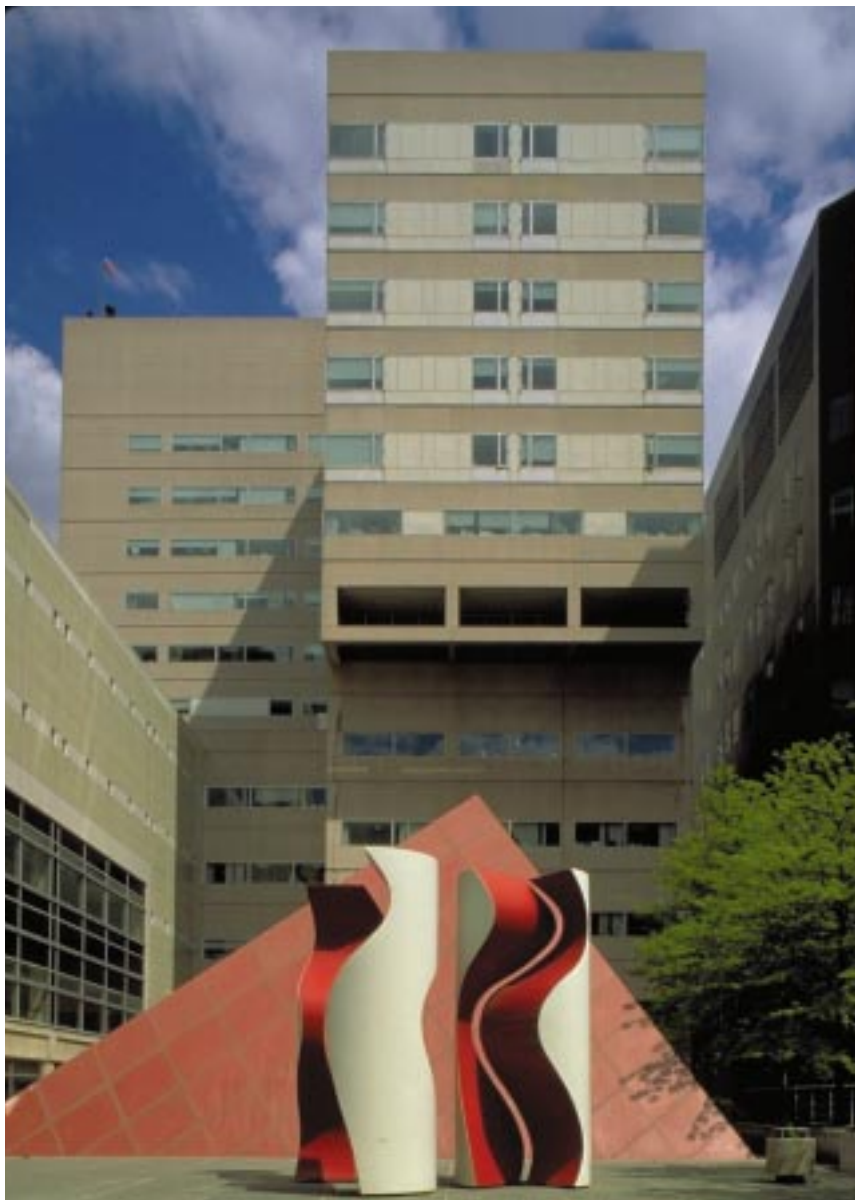
TUITION, FEES AND STUDENT AID

During Fiscal Year 1998, the University recorded an \$18 million increase in tuition and fee revenue to a total of over \$350 million, net of direct grants. This represents an increase of more than 5.5% over Fiscal Year 1997. The University was able to continue its need-blind undergraduate admissions policy, with 58% of Penn undergraduate students receiving some type of financial aid. Overall, undergraduate and graduate direct grants totaled almost \$90.7 million for the year. Continuing our recent trend, the admissions process for Penn's undergraduate program, as well as for numerous graduate programs, has never been as competitive nor the number of applications so high.

DEVELOPMENT

Development and Alumni Relations exceeded its fundraising target for Fiscal Year 1998, recording almost \$232 million in contributions — an 80% increase over last year. The University's annual funds produced a record-setting total of \$23.4 million, up from \$21 million in Fiscal Year 1997. Penn's development program was energized by significant new gifts for the *Agenda for Excellence*. Seventy percent of all gifts in Fiscal Year 1998 were for the *Agenda*, bringing total support for the *Agenda for Excellence* priorities since July 1996 to \$382 million. These gifts support student financial aid, new endowed professorships, innovative interdisciplinary academic programs and research, and new facilities for the Wharton School, the School of Dental Medicine, the Law School, the University Museum, and the Biological Sciences.

1998 marked the centennial year of the University of Pennsylvania Alumni Society. Alumni Relations celebrated that milestone by embarking on a new vision that expands communications with alumni worldwide and focuses particular attention on new programming designed to achieve lifelong involvement. Work also began on the first all-University alumni directory in more than seven decades.



SPONSORED PROGRAMS

Fiscal Year 1998 proved to be another extremely successful year for sponsored programs support at the University. Total awards for the year reached \$414 million, an increase of 14.1% over the previous year. Sponsored programs revenue totaled over \$355 million, a 15% increase over Fiscal Year 1997. As noted above, the School of Medicine moved up to a number three ranking in funding from NIH, while our School of Nursing was ranked number one nationally among nursing schools in NIH funding.

ENDOWMENT AND INVESTMENTS

At June 30, 1998, the University's endowment had increased approximately \$525 million for the year, or 21%, to a fair value of \$3.06 billion. While most of this increase in the endowment's fair value was attributable to the increase in net assets discussed above, some of the increase resulted from the mergers of Pennsylvania and Phoenixville Hospitals into UPHS during Fiscal Year 1998. This year we completed the transition from management of our investments by our Trustees to outside investment managers. The University will be forever grateful to those Trustees who have donated their time over the years to the excellent long-term performance of our endowment. The University hired its first Chief Investment Officer last year to work closely with our Trustee Investment Board.

HEALTH SERVICES COMPONENT

The University Trustees formed the University of Pennsylvania Health System in June 1993. The Health System operates an integrated system that delivers education, research and patient care. At June 30, 1997, the Health Services Component of UPHS was comprised of the Hospital of the University of Pennsylvania (HUP), the Clinical Practices of the University of Pennsylvania, the Presbyterian Medical Center of the University of Pennsylvania Health System, Franklin Physician Services, Inc., Clinical Care Associates, and Wissahickon Hospital. During Fiscal Year 1998, two additional hospitals were merged into the Health System: Phoenixville Hospital on July 1, 1997 and Pennsylvania Hospital on October 31, 1997. Both are housed in newly formed subsidiaries, Phoenixville Hospital of the University of Pennsylvania Health System and Pennsylvania Hospital of the University of Pennsylvania Health System, respectively.

Fiscal Year 1998 proved to be another extremely challenging year for the health care industry, particularly in the greater Philadelphia area. The region continues to face intense competition, ongoing consolidation of health care entities and a surplus of beds. A key competitor experienced severe financial problems that unnerved the healthcare market, both locally and nationally. The consolidation of purchasing power in the hands of two major private payers and diffuse market share among competing health systems in the region continues to place downward pressure on reimbursement rates in Philadelphia.



Overall for Fiscal Year 1998, the Health Services Component, before consolidation, experienced an operating loss of \$46 million, and a decrease in net assets of almost \$32 million before inter-entity transfers. Revenues increased \$36 million over the prior year, but expenses increased more than \$121 million. As of June 30, 1998, the Health System Component had total net assets of \$618 million, of which \$345 million was unrestricted.

Even during these challenging times, the Health System continued its standard of excellence in the delivery of health care. HUP was the only hospital in the country to receive a Quality Award from the National Council for Quality in Health Care. *U.S. News & World Report* included HUP in its Honor Roll of Hospitals (which includes the top 16 hospitals in the nation) and ranked the Health System highest in the region in thirteen specialties. The reputation and ranking of the School of Medicine and its major departments continued to rise, with the School of Medicine ranked the nation's number four medical school by *U.S. News & World Report*.

CAPITAL INVESTMENT

During Fiscal Year 1998, the University invested over \$250 million in new construction, renovation, and the purchase of property, plant and equipment to support our teaching and research missions. As a major research university, it is especially important to enhance our research capacity and strengthen our competitive position in science and technology. A major part of the overall strategy includes the construction of new state-of-the-art research facilities. In October of 1997, the Roy and Diana Vagelos Laboratories of the Institute for Advanced Science and Technology opened. Construction also continued on our second new biomedical research building, projected to open during the spring of 1999. These facilities provide modern and technologically advanced laboratories for medical research.

The University also continued to make significant investments to improve the quality of life for students, faculty and staff within and around campus. Renovations to the 40th Street corridor between Walnut and Locust were completed, along with the first phases of a campus lighting plan. Construction continued on both the Perelman Quadrangle/Wynn Common and Sansom Common projects. These projects will provide for an enhanced quality of life for our students. The Public Safety Department was relocated to a renovated facility near 40th and Chestnut, where their operations were consolidated in order to improve delivery of services to the University community.

In early January 1998, the University issued \$200 million in new debt to finance these projects, as well as a number of new initiatives that will be undertaken in the next few years. These include a new building for the Wharton School of Business, renovations and construction of student housing facilities and the construction of a chilled water plant.



RESTRUCTURING

During the past year, the Division of Finance completed several restructuring projects in support of the administrative restructuring goal detailed in the *Agenda for Excellence* as well as the planning for the first major upgrade to the financial management information system implemented several years ago.

In September, the University opened a newly renovated Student Financial Center. The new center consolidates Student Financial Services, the Registrar, the Cashier and the PennCard Center in a single location. The concept of “one-stop shopping” for students got started in earnest at Penn ten years ago. This concept has led to three overarching goals to take advantage of new technologies and provide innovative service improvements for our students. These goals include:

- reducing the need for students to visit the central facility by automating many services,
- placing in the hands of students and administrators the means to solve their own financial problems through the use of web based on-line tools, and
- training the first contact person to be able to solve any problem if a visit is necessary.

In order to support the burgeoning research enterprise, several improvements were made in the way research services are delivered to our schools and centers. Most notably, the Office of Research Administration was merged with Research Accounting to create a new entity, Research Services. Research Services seeks to provide more efficient support for the pre- and post-award research processes, enhanced training programs for administrators and principal investigators, and more comprehensive documentation of research policies and procedures. In addition, preliminary work was initiated toward the development of new systems capabilities to support the research enterprise.

SUMMARY

While Fiscal Year 1998 was a challenging year, it was also a year in which the positive outcomes of University efforts over the past several years were publicly acknowledged. In addition to the notable rankings of the Health System discussed above, the University is now the sixth ranked university in the country by *U.S. News & World Report*.

The University continues to aggressively pursue the goals of the *Agenda for Excellence*, while maintaining a vigilant watch over the present day issues and environment. Ingrained in this institution is the strong belief that we must efficiently manage our resources today while we pursue the goals of tomorrow. We believe that this is very much evidenced by all that has transpired during this past year.

Kathryn Engbreitson



FINANCIALS

A FIVE-YEAR REVIEW OF INVESTMENTS

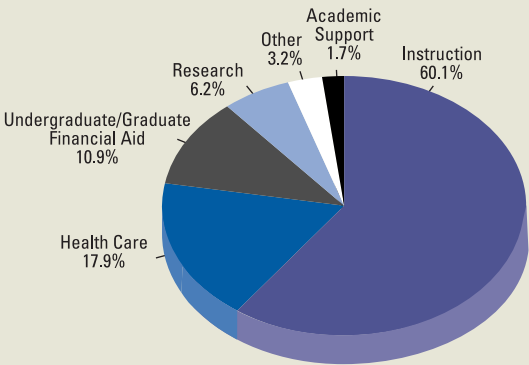
University of Pennsylvania
(thousands of dollars)

	1998	1997	1996	1995	1994
Investments:					
Fair Value					
Stocks	\$1,780,483	\$1,474,925	\$967,484	\$807,602	\$659,146
Bonds	1,244,519	1,424,951	1,348,576	939,934	889,369
Short-term	536,608	403,303	548,151	699,164	672,707
Other	215,025	168,961	135,225	100,703	80,661
Total Investments	\$3,776,635	\$3,472,140	\$2,999,436	\$2,547,403	\$2,301,883
Cost					
Stocks	\$1,434,745	\$1,179,632	\$847,373	\$665,171	\$576,776
Bonds	1,235,824	1,242,192	1,346,675	923,859	917,410
Short-term	536,608	402,602	545,617	703,141	672,700
Other	165,541	145,188	120,842	88,191	72,742
Total Investments	\$3,372,718	\$2,969,614	\$2,860,507	\$2,380,362	\$2,239,628
Endowment:					
Fair Value	\$3,059,401	\$2,535,312	\$2,108,961	\$1,675,740	\$1,464,455
Cost	\$3,009,100	\$2,202,511	\$1,986,641	\$1,513,309	\$1,403,735
Associated Investments Fund:					
Fair Value	\$2,138,012	\$1,856,663	\$1,527,651	\$1,255,411	\$1,064,865
Cost	\$1,899,007	\$1,622,538	\$1,438,583	\$1,113,163	\$997,548

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. The endowment funds 3.1% of the University's consolidated operating budget. At June 30, 1998, the endowment reached a record high market value of \$3.06 billion, attributable in part to the total investment return of 13.3% attained over fiscal year 1998. The market value of the endowment increased by \$524 million over the year, with such gain being comprised by net investment appreciation of \$250 million, net gifts and transfers to endowment of \$259 million, and income reinvestment of \$15 million.

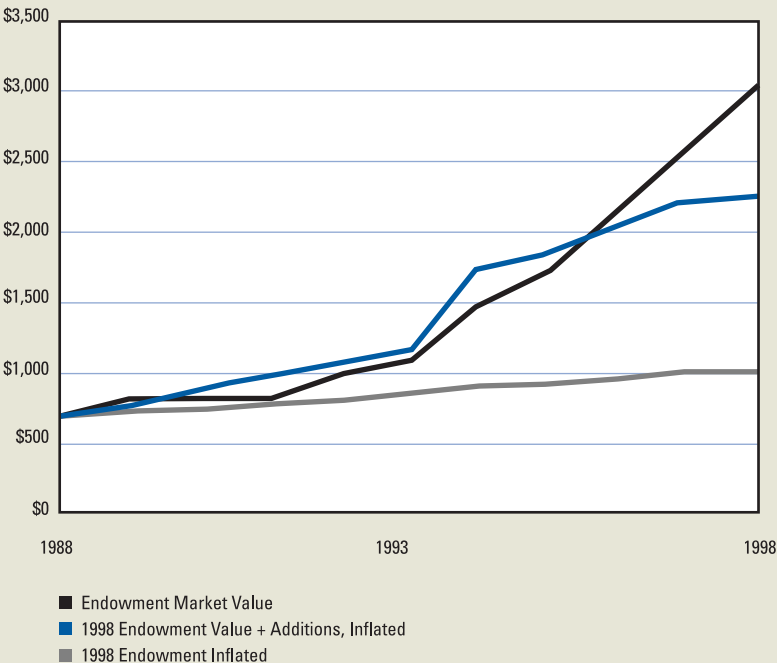
ENDOWMENT BY PURPOSE



The total endowment includes the endowment of all of Penn's schools and centers. The endowments serve a variety of purposes. The chart above reflects the breakdown of endowment by purpose.

One objective in managing the endowment is to achieve growth in real value. The following chart reflects the growth in the endowment for the past ten years. The impact of both performance and gifts is shown. The chart shows that the endowment's growth has significantly outpaced inflation over this time period. Note that the endowment market value excludes the portion of returns which have been spent. Including such distributions would make the comparison of endowment performance with inflation even more favorable.

ENDOWMENT GROWTH VS. INFLATION

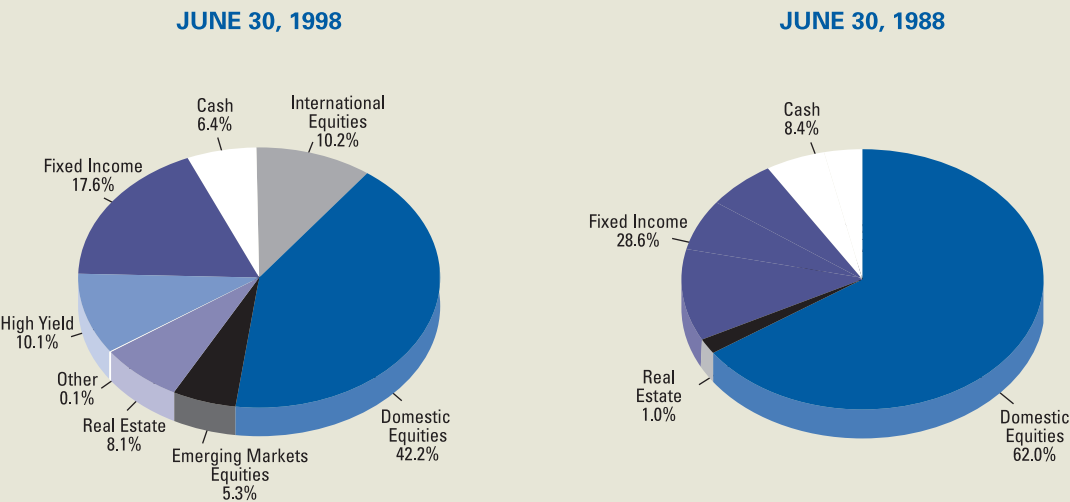


ASSOCIATED INVESTMENTS FUND

University of Pennsylvania, June 30, 1998

Associated Investments Fund

Approximately 73% of the University’s endowment is invested in the Associated Investments Fund (“A.I.F.”), an open ended, pooled investment fund which had a market value of \$2,138,012,000 as of June 30, 1998. One of the key determinants of investment performance is asset allocation. This allocation has changed dramatically over the years as the A.I.F.’s diversification has increased, reducing its dependence on domestic marketable equities and fixed income. This shift in asset allocation is illustrated below.



ASSOCIATED INVESTMENTS FUND

University of Pennsylvania, June 30, 1998

The A.I.F. is managed for total return, as investment returns are sought from both current income and principal appreciation. For the five-year period ending June 30, 1998, the A.I.F. generated an average annual compounded total investment return of 15.2%. This return compares with the 15.0% average university endowment return (as reported by Cambridge Associates). Longer measurement periods provide a meaningful context in which to evaluate investment performance and are shown in the chart below.

TOTAL RETURN PERFORMANCE COMPARISON

Period Ended June 30, 1998

Annualized Returns (%)

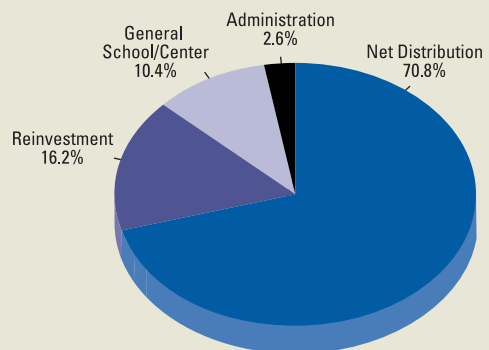
Category	20 Years	15 Years	10 Years	5 Years	1 Year
A.I.F.	15.5	14.9	13.2	15.2	13.3
Composite Index*	14.4	14.3	14.5	15.6	17.0
S&P 500	17.4	17.2	18.5	23.1	30.1
Lehman Bros. Government/Corporate	10.0	10.1	9.1	6.9	11.3

* The Composite Index represents the S&P 500, EAFE, MSCI Emerging Markets Free, NCREIF, Lehman Gov't/Corp., Salomon High Yield indices on a weighted basis equal to the AIF's long-term asset allocation objective beginning 1/1/96. Previously, the Index reflected the S&P 500, Lehman Gov't/Corp. & Salomon High Yield weighted to the actual equity, fixed & high yield allocations.

A.I.F. Distributions

In addition to principal gains and gifts, a total of \$80,715,000 was earned from interest and dividend payments on assets held in the A.I.F. in Fiscal Year 1998. From this total, \$13,101,000 was reinvested into principal pursuant to the A.I.F. spending rule policy, described below. Additionally, \$2,091,000 was applied to investment administration charges, which support the internal costs of investment management. An allocation of \$8,341,000 was made for general school/center support, which covers the general overhead (e.g., heat, light, maintenance) of the schools and centers benefiting from the endowment. The net distribution following these deductions was \$57,183,000, which went to support a variety of university purposes, dependent on the restrictions of each endowment fund held in the A.I.F. The distribution of A.I.F. income for Fiscal Year 1998 is reflected to the right.

DISTRIBUTION OF 1998 INCOME



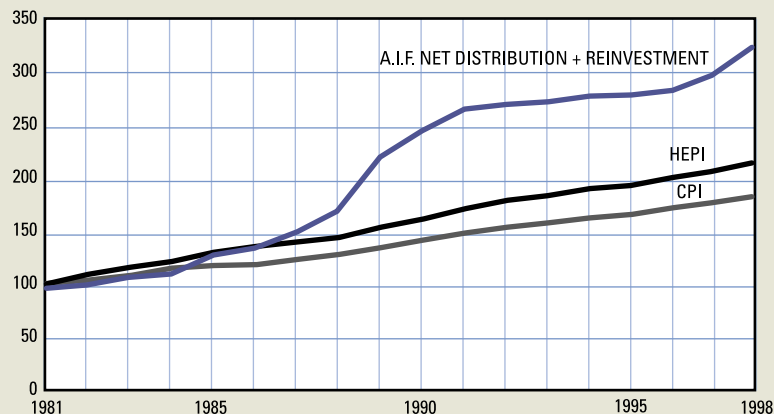
A.I.F. Spending Rule Policy

In Fiscal Year 1981, the Trustees implemented an endowment spending policy. Prior to that, all interest and dividends earned were distributed to A.I.F. unitholders. The primary purpose of implementing a spending policy was to protect the purchasing power of the endowment against the impact of inflation. In addition, the spending rule policy seeks to provide smooth and predictable endowment distributions. The spending rule policy in place for Fiscal Year 1998 was to spend 4.7% of the three-year moving average A.I.F. market value, lagged by one year. This rate is known as the “spending rate.” Because the spending rate is based on a three-year moving average market value, the spending rate is different when stated in the context of the current market value. Based on the June 30, 1997 market value, the spending rate was 3.5%.

Since inception of the spending rule in Fiscal Year 1981, a total of \$158 million of income earned has been reinvested into the A.I.F. The impact of this reinvestment means that A.I.F. participants in Fiscal Year 1981 now hold approximately 37% more units and receive 37% more income annually than they would otherwise. The chart below reflects the growth in the distribution relative to the Consumer Price Index (CPI) and Higher Education Price Index (HEPI) since 1981. As reflected, the net distribution generated by the A.I.F., adjusted for such reinvestment, has dramatically outpaced both the CPI and HEPI. The A.I.F. net distribution has grown by 6.7% annually versus 4.8% for HEPI and 3.8% for the CPI.

A.I.F. DISTRIBUTION GROWTH RELATIVE TO INFLATION

Fiscal Year 1981 - Fiscal Year 1998



FY 1981 equals 100 for all series

MANAGEMENT RESPONSIBILITY FOR FINANCIAL STATEMENTS

University of Pennsylvania
Report of Management

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 44 to 56, have been prepared in accordance with generally accepted accounting principles and, as such, include amounts based on judgments and estimates by management. The University also prepared the other information included in this annual report and is responsible for its accuracy and consistency with the financial statements.

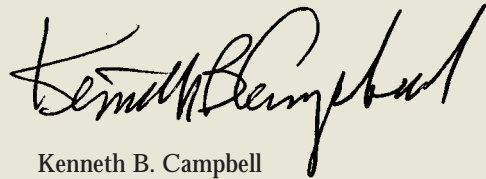
The financial statements have been audited by the independent accounting firm, PricewaterhouseCoopers, LLP, which was given unrestricted access to all financial records and related data, including minutes of all meetings of trustees. The University believes that all representations made to the independent auditors during their audit were valid and appropriate. PricewaterhouseCoopers' audit opinion is presented on page 43.

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

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



Kathryn J. Engebretson
Vice President for Finance



Kenneth B. Campbell
Comptroller

REPORT OF INDEPENDENT ACCOUNTANTS

To the Trustees of the
University of Pennsylvania
Philadelphia, Pennsylvania

In our opinion, the accompanying statement of financial position and the related statements of activities and cash flows present fairly, in all material respects, the financial position of the University of Pennsylvania at June 30, 1998, and the changes in its net assets and its cash flows for the year ended June 30, 1998, in conformity with generally accepted accounting principles. These financial statements are the responsibility of University management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with generally accepted auditing standards. 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 the opinion expressed above.

October 9, 1998

STATEMENT OF FINANCIAL POSITION

University of Pennsylvania
(thousands of dollars)

	JUNE 30, 1998	JUNE 30, 1997
Assets		
Cash and cash equivalents	\$342,899	\$197,657
Accounts receivable, net of allowances of \$13,847	87,053	88,358
Patient receivables, net of allowances of \$99,216	378,488	284,711
Investment sales receivable	100,542	24,298
Contributions receivable, net	166,209	91,754
Loans receivable, net of allowances of \$5,809	91,629	93,593
Other assets	150,440	155,840
Investments	3,776,635	3,472,140
Plant, net of depreciation	2,095,026	1,909,291
Total assets	\$7,188,921	\$6,317,642
Liabilities		
Accounts payable	\$207,800	\$176,205
Investment purchases payable	317,410	64,316
Accrued expenses and other liabilities	416,956	372,679
Deferred income	28,855	30,112
Deposits, advances, and agency funds	49,146	51,253
Federal student loan advances	66,396	65,515
Accrued retirement benefits	212,952	226,011
Debt obligations	1,373,891	1,183,418
Total liabilities	2,673,406	2,169,509
Net assets		
Unrestricted	2,342,218	2,292,517
Temporarily restricted	1,211,859	985,178
Permanently restricted	961,438	870,438
	4,515,515	4,148,133
Total liabilities and net assets	\$7,188,921	\$6,317,642

See accompanying notes to financial statements.

STATEMENT OF ACTIVITIES

University of Pennsylvania

for the year ended June 30, 1998

(with summarized financial information for the year ended June 30, 1997)

(thousands of dollars)

	UNRESTRICTED	RESTRICTED		TOTAL	
		TEMPORARILY	PERMANENTLY	1998	1997
Revenue and other support:					
Tuition and fees, net	\$350,355			\$350,355	\$332,106
Commonwealth appropriations	35,783			35,783	35,783
Sponsored programs	355,473			355,473	309,320
Contributions	27,437	\$33,152		60,589	66,167
Investment income	92,899	49,157		142,056	148,868
Hospitals and physician practices	1,471,914			1,471,914	1,424,577
Sales and services of auxiliary enterprises	70,020			70,020	66,062
Other educational activities	93,135			93,135	75,990
Independent operations	15,637			15,637	15,028
Net assets released from restrictions	89,743	(89,743)			
	2,602,396	(7,434)		2,594,962	2,473,901
Expenses:					
Program:					
Instruction	442,772			442,772	418,326
Research	292,098			292,098	246,937
Hospitals and physician practices	1,561,108			1,561,108	1,440,437
Auxiliary enterprises	74,368			74,368	73,551
Other educational activities	80,453			80,453	65,980
Student services	24,301			24,301	22,824
Support:					
Academic support	43,506			43,506	40,274
Management and general	95,456			95,456	87,288
Independent operations	15,327			15,327	13,801
	2,629,389			2,629,389	2,409,418
Increase (decrease) in net assets before nonoperating revenue, net gains, reclassifications and other	(26,993)	(7,434)		(34,427)	64,483
Nonoperating revenue, net gains, reclassifications and other:					
Gain on investments, net	52,082	138,288	\$31,244	221,614	384,692
Investment income	37,718	11,654	1,596	50,968	34,124
Contributions	16,535	96,557	58,160	171,252	62,879
Non-recurring charges	(19,299)			(19,299)	(28,897)
Transfer to First Hospital Foundation and Phoenixville Health Care Corporation	(22,726)			(22,726)	(106,144)
Net assets released from restrictions	12,384	(12,384)			
Increase in net assets	49,701	226,681	91,000	367,382	411,137
Net assets, beginning of year	2,292,517	985,178	870,438	4,148,133	3,736,996
Net assets, end of year	\$2,342,218	\$1,211,859	\$961,438	\$4,515,515	\$4,148,133

See accompanying notes to financial statements.

STATEMENT OF CASH FLOWS

University of Pennsylvania

(for the years ended June 30, 1998 and 1997)

(thousands of dollars)

	1998	1997
Cash flows from operating activities:		
Increase in net assets	\$367,382	\$411,137
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	152,254	140,533
Provision for bad debts	48,268	41,236
Gain on investments, net	(221,614)	(384,692)
Loss on disposal of plant, property, and equipment	186	3,022
Nonoperating revenue designated for the acquisition of long-lived assets	(192,526)	(75,367)
Write down of property and equipment	1,538	95,817
Transfer to First Hospital Foundation and Phoenixville Health Care Corporation	22,726	28,897
Changes in operating assets and liabilities:		
Patient, accounts and loan receivable	(133,305)	(91,253)
Contributions receivable	(13,125)	(11,721)
Other assets	5,400	10,112
Accounts payable, accrued expenses and accrued retirement benefits	62,813	23,765
Deposits, advances and agency funds	(2,107)	13,945
Deferred income	(1,257)	(10,342)
Net cash provided by operating activities	96,633	195,089
Cash flows from investing activities:		
Student loans repaid	9,842	11,332
Student loans issued	(10,695)	(11,765)
Purchase of investments	(3,874,687)	(6,421,610)
Proceeds from sale of investments	3,968,656	6,416,443
Purchase of plant, property, equipment and physician practices	(339,713)	(337,426)
Transfer to First Hospital Foundation and Phoenixville Health Care Corporation	(6,400)	(29,031)
Net cash used by investing activities	(252,997)	(372,057)
Cash flows from financing activities:		
Nonoperating revenue designated for the acquisition of long-lived assets	126,578	83,598
Federal student loan advances	881	561
Repayment of long-term debt	(73,823)	(14,391)
Proceeds from issuance of long-term debt	247,970	72,085
Defeasance of long-term debt	--	(18,219)
Net cash provided by financing activities	301,606	123,634
Net increase(decrease) in cash and cash equivalents	145,242	(53,334)
Cash and cash equivalents, beginning of year	197,657	250,991
Cash and cash equivalents, end of year	\$342,899	\$197,657
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$53,441	\$55,266
Non-cash activity		
Due to First Hospital Foundation	\$16,326	--

See accompanying notes to financial statements.

1. Significant Accounting Policies

Organization

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

Basis of Presentation

The financial statements have been prepared on the accrual basis and include the accounts of the University of Pennsylvania and its related entities. All material transactions between the University and its related entities 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 reclassifications 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. Certain reclassifications have been made to the summarized financial information for comparative purposes.

Cash and Cash Equivalents

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

Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities 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 are included in short-term investments. Derivative financial instruments held for investment purposes are carried at fair value with the resulting gains and losses included in investment earnings for the period. The University's principal derivative financial instruments are forward mortgage contracts. The majority of the endowment funds of the University have been pooled in the University's Associated Investments Fund (A.I.F.), which is invested primarily in two investment pools, an Equity Fund and a Fixed Income Fund. Each participating fund in the A.I.F. earns investment income on the basis of each fund's percentage ownership of the A.I.F. A spending limitation is in effect on this income. Income in excess of this limitation (\$13,101,000 in 1998) is reinvested and is included in nonoperating investment income.

NOTES TO FINANCIAL STATEMENTS

University of Pennsylvania

Fair values for certain private equity and real estate investments held through limited partnerships or commingled funds are estimated by the respective external investment managers if market values are not readily ascertainable. These valuations necessarily involve assumptions and methods that are reviewed by the University.

Loans Receivable

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

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. Museum contents, rare books and other collectibles are not subject to depreciation.

Intangible Assets

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

Tuition and Fees

The University maintains a policy of offering qualified applicants admission to the University without regard to financial circumstance. This policy provides for 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 direct grants in the amount of \$90,670,000 in 1998.

Sponsored Programs

The University receives grant and contract revenue from governmental and private sources. In 1998, grant and contract revenue received from governmental sources totaled \$293,569,000. The University recognizes revenue associated with the direct costs of sponsored programs as the related costs are incurred. Indirect costs recovered on Federally-sponsored programs are based on predetermined reimbursement rates negotiated with the University's cognizant 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.

Contributions

Contributions are reported as increases in the appropriate net asset category. Contributions, including unconditional promises to give, are recognized as revenue in the period received at their fair values. Unconditional pledges are recognized at their estimated net present value, net of an allowance for uncollectible amounts, and are classified in the appropriate net asset class. Unconditional promises to give and contributions of cash and other assets designated for the acquisition of long-lived assets are reported with nonoperating revenue, net gains, reclassifications and other.

Health Services Component

Revenue of the Health Services Component is derived primarily from patient services and is accounted for at established rates on the accrual basis in the period the service is provided. Certain revenue received from third-party payors is subject to audit and retroactive adjustment. Final adjustments to revenue, resulting from settlements with third-party payors, are recorded in the year in which they are settled.

Additionally, the Health Services Component has entered into certain contracts under which it is responsible for providing medical care to covered members at predetermined rates. Any changes in estimates under these contracts are recorded in operations currently.

Excess of revenue over expenses for the Health Services Component was increased by \$10,333,000 and \$55,849,000 as a result of changes in estimates, including third-party settlements of \$14,875,000 and \$24,119,000 in 1998 and 1997, respectively.

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 that benefitted from the proceeds of the debt.

Use of Estimates

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

2. University of Pennsylvania Health System - Health Services Component

The University Trustees formed the University of Pennsylvania Health System in June 1993. The Health System operates an integrated system, which delivers education, research, and patient care. The Health System currently includes the Health Services Component and the School of Medicine. As of June 30, 1997, the Hospital of the University of Pennsylvania, the Clinical Practices of the University of Pennsylvania, the Presbyterian Medical Center of the University of Pennsylvania Health System, Franklin Physician Services, Inc., Clinical Care Associates, and Wissahickon Hospice of the University of Pennsylvania Health System comprised the Health Services Component.

On July 1, 1997, Phoenixville Hospital's net assets and business were merged into Phoenixville Hospital of the University of Pennsylvania Health System (Phoenixville Hospital), a newly formed subsidiary of the Trustees of the University of Pennsylvania. Additionally, on October 31, 1997, the Contributors to Pennsylvania Hospital's net assets and business were merged into Pennsylvania Hospital of the University of Pennsylvania Health System (Pennsylvania Hospital), a newly formed subsidiary of the University. Both mergers have been accounted for as pooling of interests and, accordingly, the consolidated information of the University has been restated to include the accounts and operations of Phoenixville Hospital and the Contributors to Pennsylvania Hospital for all periods prior to the merger. The University's reported increase in net assets was \$523,623,000 in 1997 excluding the effect of the pooling of interests of Pennsylvania Hospital and Phoenixville Hospital, a decrease in net assets of \$95,076,000 and \$17,410,000, respectively.

NOTES TO FINANCIAL STATEMENTS

University of Pennsylvania

Throughout the year, certain transactions are conducted between the Health Services Component and the University. The effect of these transactions (primarily inter-entity billings for allocations of common costs and certain purchased services) is included in the financial information of the Health Services Component.

The Health Services Component makes transfers from their operations that further the research and educational activities of the School of Medicine. These activities are integral to the overall mission of the Health System and the effect of the transfers is reflected in the Health Services Component net assets.

Summarized financial information for the Health Services Component as of June 30, 1998 and 1997, prior to eliminations for transactions between the Health Services Component and other entities of the University, is as follows (in thousands):

	1998	1997
Net patient service and premium revenue	\$1,383,657	\$1,340,590
Other revenue	132,807	139,545
Total expenses	(1,562,541)	(1,440,437)
Excess of expenses over revenue from operations	(46,077)	39,698
Nonoperating, net	14,344	(64,032)
Decrease in net assets before inter-entity transfers	\$(31,733)	\$(24,334)
Total current assets	\$570,834	\$425,953
Investments and assets whose use is limited (including Board designated funds of \$457,877 and \$583,098 and trustee held funds of \$50,740 and \$137,929 for 1998 and 1997, respectively)	818,917	997,969
Property, plant and equipment, net	675,696	655,009
Other assets	100,824	110,703
Total assets	\$2,166,271	\$2,189,634
Total current liabilities	\$484,576	\$324,707
Long-term debt, net of current portion	761,790	825,498
Other liabilities	301,590	295,693
Total liabilities	1,547,956	1,445,898
Net assets		
Unrestricted	345,268	502,530
Temporarily restricted	216,331	184,617
Permanently restricted	56,716	56,589
Total net assets	618,315	743,736
Total liabilities and net assets	\$2,166,271	\$2,189,634

NOTES TO FINANCIAL STATEMENTS

University of Pennsylvania

3. Investments

A summary of investments, stated at fair value, at June 30, 1998 is as follows (in thousands):

Short-term	\$536,608
Stocks	1,780,483
Bonds	1,244,519
Real estate	188,184
Other	26,841
End of year	<u>\$3,776,635</u>
Beginning of year	<u>\$3,472,140</u>

Included in investments are assets held in trust with an aggregate fair value of \$152,335,000 at June 30, 1998.

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, 1998, short-term investments held under this arrangement aggregated \$9,336,000.

At June 30, 1998, investments with a fair value of \$54,082,000 were held by trustees under indenture and escrow agreements.

At June 30, 1998, investment securities with an aggregate fair value of \$20,643,000 were loaned primarily on an overnight basis to various brokers in connection with a securities lending program. These securities are returnable on demand and are collateralized by cash deposits amounting to 102% of the market value of the securities loaned. The University receives lending fees and continues to earn interest and dividends on the loaned securities.

4. Contributions Receivable

A summary of contributions receivable is as follows at June 30, 1998 (in thousands):

Unconditional promises expected to be collected in:	
Less than one year	\$76,969
One year to five years	125,879
Over five years	34,388
	<u>237,236</u>
Less: Unamortized discount and allowance for doubtful amounts	<u>(71,027)</u>
Contributions receivable, net	<u>\$166,209</u>

At June 30, 1998, the University also received conditional promises to give of approximately \$30,254,000, which are not recognized as assets. When they become unconditional promises to give or are received in cash or kind, they generally will be restricted for specific purposes as stipulated by the donors.

NOTES TO FINANCIAL STATEMENTS

University of Pennsylvania

5. Plant

The components of plant at June 30, 1998 are as follows (in thousands):

Land	\$54,666	
Buildings	2,223,137	(a), (b)
Contents	1,123,856	(c)
	<u>3,401,659</u>	
Less accumulated depreciation	<u>(1,306,633)</u>	
Plant	<u>\$2,095,026</u>	

(a) Includes \$252,429,000 of construction-in-progress.

(b) Includes \$104,790,000 of completed facilities which serve as collateral for debt obligations.

(c) Museum contents, rare books and other collectibles not subject to depreciation aggregate \$12,376,000 at June 30, 1998.

The University recorded \$141,401,000 of depreciation expense for the year ended June 30, 1998.

6. Debt Obligations

Debt obligations at June 30, 1998 are as follows (in thousands):

Pennsylvania Higher Education Facility Authority (PHEFA) Series A and B 1996 Revenue Bonds, (4.60%-6.00%), net of unamortized discount of \$2,802 (a), (o)	\$436,438
PHEFA Series 1998 Revenue Bonds, (4.50% - 5.50%), net of unamortized discount of \$2,347 (b)	197,653
PHEFA Series A of 1995 Revenue Bonds, (4.7% - 7.0%) (c)	107,250
PHEFA Series B of 1994 Revenue Bonds, (variable interest rate, 3.50% at June 30, 1998) (d), (o)	90,000
PHEFA Series C of 1996 Revenue Bonds, (variable interest rate, 3.50% at June 30, 1998) (e), (o)	80,000
Quakertown General Authority Pool Financing Program, 1985 Series A Bonds, (variable interest rate, 4.54% at June 30, 1998) (f)	66,635
Washington County Authority Lease Revenue Bonds, Series 1985 A, (variable interest rate, 3.65% at June 30, 1998) (g)	50,788
PHEFA Series B of 1995 Revenue Bonds, (4.85% - 7.0%) (c)	46,705
Hospitals and Higher Education Facilities Authority (HHEFA) Series A of 1994 Revenue Bonds, (average fixed rate in 1998 of 5.32%) (h)	37,245
PHEFA Series A of 1994 Revenue Bonds, (5.6% - 7.0%), including unamortized premium of \$828 (i), (o)	35,828
HHEFA Series C of 1994 Revenue Bonds, (variable interest rate, 3.95% at June 30, 1998) (j)	31,380
HHEFA Series B of 1994 Revenue Bonds, (variable interest rate, 3.60% at June 30, 1998) (j)	30,585
PHEFA Series of 1968 Revenue Bonds, (4.9%) (k)	26,540
Pennsylvania Economic Development Financing Authority Series C of 1994 Revenue Bonds, (variable interest rate, 5.65% at June 30, 1998) (l)	11,250
PHEFA Second Series of 1985 Revenue Bonds, (variable interest rate, 3.90% at June 30, 1998) (m)	10,610
PHEFA Series of 1990 Revenue Bonds, (variable interest rate, 3.90% at June 30, 1998) (n)	6,500
Mortgages payable and other, (6.01% weighted average interest rate, due through 2008)	108,484
	<u>\$1,373,891</u>

NOTES TO FINANCIAL STATEMENTS

University of Pennsylvania

- (a) The Series A and B of 1996 Bonds mature in varying annual amounts ranging from \$11,335,000 in 1999 to \$13,440,000 in 2002, with maturities of \$8,970,000 in 2021 and \$9,590,000 in 2022. The Bonds are subject to optional redemption by the Authority prior to their scheduled maturity at redemption prices of 101%, 100.5%, and 100% plus accrued interest in 2006, 2007, and thereafter, respectively. The Bonds maturing in 2017 and 2022 are subject to mandatory sinking fund redemption at a price of 100% plus accrued interest in 2016 through 2022.
- (b) The Series of 1998 Bonds mature in varying annual amounts ranging from \$1,710,000 in 1999 to \$11,245,000 in 2039. The Bonds are subject to optional redemption by the Authority on or after July 15, 2008 at a redemption price of 100% plus accrued interest. Annual debt service payments to the Authority extending through 2039 range from \$9,642,000 in 1999 to \$11,554,000 in 2039.
- (c) The Series A and Series B of 1995 Bonds mature in varying annual amounts ranging from \$3,460,000 in 1998 to \$9,345,000 in 2016. The Bonds are subject to optional redemption by the Authority on or after September 1, 2005 at a redemption price of 100% plus accrued interest. Annual debt service payments to the Authority extending through 2016 range from \$8,979,000 in 1998 to \$14,349,000 in 2016.
- (d) The Series B of 1994 Bonds mature in varying amounts ranging from \$16,900,000 in 2020 to \$19,100,000 in 2024. The Bonds bear a floating rate of interest which is adjusted by the Authority at certain intervals. The Bonds are subject to optional redemption by the Authority prior to their scheduled maturity at a redemption price of 100% plus accrued interest.
- (e) The Series C of 1996 Bonds mature in varying annual amounts ranging from \$9,100,000 in 2023, \$9,700,000 in 2024, \$30,000,000 in 2025 and a final maturity of \$31,200,000 in 2026. The Bonds have a variable interest rate, but are eligible to be changed to a fixed rate as elected by the Authority. The Bonds are subject to optional redemption by the Authority prior to their scheduled maturity at a redemption price of 100% plus accrued interest.
- (f) The 1985 Series A Bonds mature on June 1, 2005 and are subject to optional prepayments as stipulated in the Loan Agreement. The Bonds bear a floating rate of interest which is adjusted by the Authority at certain intervals.
- (g) The Series A of 1985 Bonds mature on November 1, 2005 and are subject to advance payments and optional prepayments as stipulated in the Lease Agreement. The Bonds bear a floating rate of interest which is adjusted by the Authority at certain intervals. The Authority has the option to convert the interest rate on the Bonds to a fixed rate.
- (h) The Series A of 1994 Bonds mature in varying amounts ranging from \$1,620,000 in 2007 to \$5,870,000 in 2014. The Bonds are subject to optional redemption by the Authority prior to their scheduled maturity at redemption prices of 104%, 102%, and 100% plus accrued interest in 2004, 2005, and thereafter, respectively.
- (i) The Series A of 1994 Bonds mature in varying amounts from \$3,340,000 in 2003 to \$5,205,000 in 2010. The Bonds are subject to optional redemption by the Authority prior to their scheduled maturity at redemption prices of 102%, 101% and 100% plus accrued interest in 2004, 2005, and thereafter, respectively.
- (j) The Series B and C of 1994 Bonds mature in varying annual amounts ranging from \$1,875,000 in 1999 to \$3,385,000 in 2019 with maturities of \$2,015,000 in 2019 and \$1,480,000 in 2023. The Bonds are subject to optional redemption on any interest payment date at a redemption price equal to the principal amount plus accrued and unpaid interest, if any, to the fixed redemption date.
- (k) The Series of 1968 Bonds mature in 2008. Annual debt service payments to the Authority extending through 2008 are approximately \$3,400,000.
- (l) The Series C of 1994 Bonds mature in varying annual amounts ranging from \$400,000 in 1999 to \$1,200,000 in 2014. The Bonds are subject to optional redemption on any interest payment date at a redemption price equal to 100% of principal amount plus accrued interest to redemption date.

NOTES TO FINANCIAL STATEMENTS

University of Pennsylvania

- (m) The Second Series of 1985 Bonds have a variable interest rate which is based on the discount rate of short-term United States government securities and may be converted to a fixed rate at the Authority's option. The Bonds mature in 2015, subject to earlier redemption by bond holders (prior to conversion to a fixed rate) or the Authority.
- (n) The Series of 1990 Bonds have a variable interest rate which is based on the discount rate of short-term United States government securities and may be converted to a fixed rate at the Authority's option. The Bonds mature on December 1, 2020, subject to earlier redemption by bond holders (prior to conversion to a fixed rate) or the Authority.
- (o) Master Trust Indenture limits the respective indebtedness to the assets and revenue of the Hospital, Clinical Practices, and Presbyterian Medical Center (designated units). The indenture and related agreements contain certain restrictive covenants which limit the issuance of additional indebtedness of the designated units and, among other things, require the designated units to maintain "net revenue" (excess of revenue over expenses plus depreciation, interest and amortized finance costs relating to the bonds) at an amount equal to 110% of the annual debt service requirements. Effective August 13, 1998, Pennsylvania Hospital and Phoenixville Hospital became members of the obligated group under the Master Trust Indenture.

The fair value of the University's debt obligations was \$1,433,650,000 at June 30, 1998. The fair value represents the quoted market value for Authority Revenue Bonds and carrying amounts for all other debt.

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

Fiscal Year	Amount
1999	\$37,877
2000	41,399
2001	55,020
2002	28,485
2003	38,938

7. Debt Obligations Refunded in Advance

The HHEFA Revenue Bonds, Series A of 1996 were legally defeased. In addition, Pennsylvania Hospital legally defeased its outstanding Hospital Revenue Bonds, Series of 1992. The defeasances were accomplished by depositing sufficient funds in irrevocable escrow accounts maintained by trustees. The escrowed amounts will be used to satisfy all principal and interest requirements relating to the defeasance of the bonds. Accordingly, the obligation to repay the bonds is no longer included in the Statement of Financial Position of the University. At June 30, 1998, \$48,945,000 of bonds is considered legally defeased.

On July 1, 1998, the Health Services Component borrowed sufficient funds from a bank to retire the HHEFA Series C of 1994 Revenue Bonds. On August 13, 1998, the bank loan was repaid and the Series A and B of 1994 were legally defeased through the issuance of the PHEFA Series A and B of 1998 Revenue Bonds.

8. Pension and Other Postretirement Benefit Costs

Retirement benefits are provided for academic employees and certain administrative personnel through a defined contribution plan. The University's policy with respect to its contribution is to provide up to 9% of eligible employees' salaries. The University's contributions amounted to \$26,519,000 in 1998.

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 proceeding retirement. Contributions to the plans are made in amounts necessary to at least satisfy the minimum required contributions, as specified in the Internal Revenue Service Code and related regulations.

NOTES TO FINANCIAL STATEMENTS

University of Pennsylvania

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

	Pension Benefits	Other Postretirement Benefits
Change in benefit obligation:		
Benefit obligation at June 30, 1997	\$407,030	\$189,768
Service cost	16,323	8,121
Interest cost	26,062	12,631
Plan participants' contributions	--	82
Actuarial gain	(179)	(1,717)
Benefit paid	(14,540)	(8,980)
Benefit obligation at June 30, 1998	\$434,696	\$199,905
Change in plan assets:		
Fair value of plan assets at June 30, 1997	\$447,263	\$41,377
Actual return on plan assets	75,828	5,227
Employer contribution	512	11,827
Plan participants' contribution	--	33
Benefits paid	(14,540)	(2,348)
Fair value of plan assets at June 30, 1998	\$509,063	\$56,116
Reconciliation of funded status:		
Funded status	\$74,367	\$(143,789)
Unrecognized net actuarial gain	(129,223)	(3,128)
Unrecognized prior service cost	512	--
Unrecognized transition obligation	(5,578)	--
Accrued benefit cost	\$(59,922)	\$(146,917)
Weighted-average assumptions as of end of year:		
Discount rate	6.50% to 7.75%	
Expected return on plan assets	9.25% to 9.50%	
Rate of compensation increase	4.00% to 5.50%	

The health care trend rate was assumed to decrease gradually from a range of 8.00% to 9.50% in 1998 to 4.50% to 6.00% over the next six to nine years, and remain level thereafter.

	Pension Benefits	Other Postretirement Benefits
Service cost	\$16,323	\$8,121
Interest cost	26,062	12,631
Expected return on plan assets	(40,763)	(4,116)
Amortization of prior service cost	170	--
Amortization of transition obligation (asset)	(1,019)	--
Amortization of net actuarial gain	(6,607)	(743)
Net periodic benefit cost	\$(5,834)	\$15,893

NOTES TO FINANCIAL STATEMENTS

University of Pennsylvania

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:

	1-Percentage Point Increase	1-Percentage Point Decrease
Effect on total of service and interest cost	\$3,968	\$(3,207)
Effect on accumulated postretirement benefit obligation	\$30,181	\$(25,201)

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

9. Medical Professional Liability Claims

The University is insured for medical professional liability claims through the combination of the Medical Professional Liability Catastrophe Loss Fund of the Commonwealth of Pennsylvania, various commercial insurance companies, and a risk retention program. 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 an analysis of historical claims data by an independent actuary.

10. Contingencies

The University has guaranteed certain obligations, principally mortgages and leases on properties owned by related parties, totaling \$52,115,000 at June 30, 1998. 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.

11. Non-Recurring Charges

Non-recurring charges in 1998 include the loss on extinguishment of debt, costs associated with the closure of Franklin Physician Services Inc., costs associated with the merger of Pennsylvania and Phoenixville Hospitals into the Health Services Component, and the write-off of Hill Clinical Associates, a joint venture, with an affiliated hospital.

Non-recurring charges in 1997 include the charge of \$95,800,000 resulting from a reduction to Pennsylvania Hospital's property and equipment to fair value, in accordance with the requirements of SFAS No. 121, "Accounting for Impairment of Long Lived Assets to be Disposed of." The remainder of the non-recurring charges relate to the early retirement programs and costs associated with the mergers.

TRUSTEES

AS OF JUNE 30, 1998

Mrs. Madlyn K. Abramson
Blue Bell, PA

* **Hon. Arlin M. Adams**
Of Counsel
Schnader, Harrison, Segal & Lewis
Philadelphia, PA

* **Gustave G. Amsterdam, Esq.**
Retired Chairman and CEO
Bankers Securities Corp.
Philadelphia, PA

* **Hon. Leonore Annenberg**
Former Chief of Protocol of
the United States
Wynnewood, PA

* **Hon. Walter H. Annenberg**
Former Ambassador to the
United Kingdom
Chairman and President,
The Annenberg Foundation
St. Davids, PA

* **Mr. Walter G. Arader**
Chairman
Walter G. Arader & Associates Inc.
Radnor, PA

* **Mr. Samuel H. Ballam, Jr.**
Bryn Mawr, PA

Ms. Lynda Barness
Vice President
The Barness Organization
Warrington, PA

Mrs. Judith Roth Berkowitz
President
Jarby, Inc.
New York, NY

* **Mr. Gordon S. Bodek**
Los Angeles, CA

* **Richard P. Brown, Jr., Esq.**
Counsel
Morgan, Lewis & Bockius
Philadelphia, PA

Mr. Christopher H. Browne
General Partner
Tweedy, Browne Company, L.P.
New York, NY

* **Mr. I. W. Burnham II**
Honorary Chairman
Burnham Securities, Inc.
New York, NY

Gilbert L. Casellas, Esq.
McConnell Valdés LLP
Washington, DC

Mrs. Susan W. Catherwood
Bryn Mawr, PA

Mr. Richard J. Censits
Consultant to Business
Naples, FL

* **Mr. Henry M. Chance II**
Former Chairman
United Engineers
and Constructors, Inc.
Kennett Square, PA

* *Emeritus*

Dr. Gloria Twine Chisum
Retired Research Psychologist
Philadelphia, PA

Mr. L. John Clark
Founding Partner
Compass Partners International LLC
London, United Kingdom

Dr. Stanley N. Cohen
Professor of Genetics and Professor of
Medicine
Stanford University School of Medicine
Palo Alto, CA

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Retired Chairman
Scott Paper Co.
West Conshohocken, PA

* **Mr. G. Morris Dorrance, Jr.**
Chairman Emeritus
CoreStates Financial Corp
and CoreStates Bank, N.A.
Villanova, PA

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Chief Investment Officer
The Rockefeller University
New York, NY

Mr. Jerome Fisher
Chairman
Nine West Group
White Plains, NY

Mr. Richard L. Fisher
Partner
Fisher Brothers
New York, NY

Mr. Robert A. Fox
President & Chairman
R.A.F. Industries
Jenkintown, PA

* **Bruce J. Graham, FAIA**
Partner
Graham and Graham Architecture and
Interior Design
Hobe Sound, FL

Mrs. Mary Ann Greenawalt
President
B&B Specialty Foods
Bloomfield Hills, MI

Charles A. Heimbold, Jr., Esq.
Chairman and CEO
Bristol-Myers Squibb Co.
New York, NY

Norman P. Hetrick, Esq.
Partner
Eckert Seamans Cherin & Mellott
Harrisburg, PA

* **Hon. A. Leon Higginbotham, Jr.**
Of Counsel
Paul, Weiss, Rifkind, Wharton & Garrison
New York, NY

Mr. John C. Hover II
Executive Vice President
U.S. Trust Company of New York
New York, NY

Mrs. Elsie Sterling Howard
Sterling Public Relations
Miami Beach, FL

Mr. Jon M. Huntsman, Jr.
Vice Chair
The Huntsman Corporation
Salt Lake City, UT

* **Mr. Reginald H. Jones**
Retired Chairman and CEO
General Electric Co.
Stamford, CT

Mr. Edward W. Kane
HVP Partners, LLC
Boston, MA

* **Dr. Carl Kaysen**
David W. Skinner Professor
Emeritus of Political Economy
Massachusetts Institute of Technology
Cambridge, MA

Mr. Paul K. Kelly
President and CEO
Knox & Co.
Westport, CT

Mr. James J. Kim
Amkor Technology, Inc.
West Chester, PA

Mr. Yotaro Kobayashi
Chairman and CEO
Fuji Xerox Co., Ltd.
Tokyo, Japan

Natalie I. Koether, Esq.
Counsel
Rosenman & Colin
Far Hills, NJ

Edwin Krawitz, Esq.
Partner
Krawitz & Krawitz
Stroudsburg, PA

* **Dr. Ralph Landau**
Listowel Incorporated
New York, NY

Thomas F. Lang, Sr., Esq.
Partner
Allen, Lang, Morrison & Curotto, PA
Orlando, FL

Dr. Donald N. Langenberg
Chancellor
University System of Maryland
Adelphi, MD

Mr. Leonard A. Lauder
Chairman of the Board and CEO
The Estée Lauder Companies Inc.
New York, NY

Dr. Arnold J. Levine
Harry C. Wiess Professor of Life Sciences
Department of Molecular Biology
Princeton University
Princeton, NJ

Mr. Robert P. Levy
Chairman
DRT Industries, Inc.
Philadelphia, PA

Mrs. Carolyn A. Lynch
President
The Lynch Foundation
Marblehead, MA

Mr. William L. Mack
President and CEO
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