

UNIVERSITY OF THE SCIENCES IN PHILADELPHIA

NOTES TO FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2004 AND 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization—Founded in 1821, the University of the Sciences in Philadelphia (the “University”), (formerly know as Philadelphia College of Pharmacy & Science) is a nonprofit independent institution of higher education with a commitment to excellence in teaching, research and service. In 1997 the Commonwealth of Pennsylvania granted university status and in recognition of this event the name changed to the University of the Sciences in Philadelphia on July 1, 1998. As the University of the Sciences in Philadelphia, the institution consists of the following four colleges:

Philadelphia College of Pharmacy
College of Health Sciences
Misher College of Arts and Science
College of Graduate Studies

The mission of the University is to provide undergraduate, professional, and graduate education in the health professions and natural sciences. The University is committed to the principles of equal employment and equal access to education for all persons, regardless of gender, age, disability, race, creed, color, sexual orientation, or national origin.

During the fall 2003 term, the University enrolled approximately 2,687 students, which is equivalent to 2,458 full-time students or 2,286 undergraduates and first-degree students plus 172 graduates and other program majors. The undergraduate classes’ primary areas of study are doctor of pharmacy at 69%, and physical therapy at 7%.

Basis of Presentation—The financial statements of the University, which are presented on the accrual basis of accounting, have been prepared to focus on the University as a whole and to present balances and transactions in three separate classes of net assets.

The three net asset categories reflected in the accompanying financial statements are as follows:

- **Unrestricted**—Net assets, which are free of donor-imposed restrictions. This includes all revenues, expenses, gains, and losses that are not changes in permanently or temporarily restricted net assets. This category includes realized and unrealized gains on quasi-endowment investments.
- **Temporarily Restricted**—Net assets whose use by the University is limited by donor-imposed stipulations that either expire by passage of time or that can be fulfilled or removed by actions of the University pursuant to those stipulations. This category includes realized and unrealized gains on permanently restricted endowment and other long-term investments that are in excess of the Board of Trustee’s approved spending rule. Temporarily restricted net assets, which are received and used within the same year, are reported as unrestricted.

- *Permanently Restricted*—Net assets whose use by the University is limited by donor-imposed stipulations that neither expire with the passage of time nor can be fulfilled or otherwise removed by actions of the University.

Nonoperating activities reflect transactions of a long-term investment or capital nature including contributions to be invested by the University to generate a return that will support future operations, contributions to be received in the future, contributions to be used for facilities and equipment, unrealized investment gains or losses, and impairment of capitalized assets. Realized gains and losses in excess of the University's spending policy for operations are recorded as nonoperating revenue or expense.

Tuition and Fees—The University maintains a policy of offering qualified applicants admission without regard to financial circumstances. 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 these and other merit-based direct grants.

The University bills the tuition and fees for the subsequent fiscal year's summer and fall terms prior to June 30. The resulting receivables and deferred revenues at June 30 are shown on the Statement of financial position.

Contributions—Contributions received, including unconditional promises, are recognized as revenues when the donor's commitment has been received. Unconditional promises are recognized at the estimated present value of the future cash flows, net of allowances. Conditional promises are recorded when donor stipulations are substantially met. Conditional promises whose restrictions are met in the same year as the contributions have been recorded as unconditional promises. Promises of noncash assets are recorded at their fair value.

Allocation of Certain Expenses—The statement of activities presents expenses by functional classification. Operation and maintenance of plant and depreciation are allocated based on square footage. Interest expense is allocated to the functional classifications that benefited from the use of the proceeds of the debt and on an allocation based on square footage.

Cash Equivalents—Cash and cash equivalents represent demand deposits and other investments with a maturity date not exceeding 90 days at the date of purchase, whereas short-term investments reflect liquid investments with a maturity date in excess of 90 days.

Concentration of Credit Risk—The University's financial instruments, which are exposed to concentrations of credit risk, consist primarily of cash and cash equivalents, investments and deposits with bond trustees. These funds are held in various high-quality financial institutions managed by the University's personnel and outside advisors. The University maintains its cash and cash equivalents in financial institutions, which at times exceed federally insured limits. The University believes that the concentrations of credit risk are limited to its cash and cash equivalents, investments, and deposits with bond trustees.

Investments and Fair Value of Financial Instruments—The University records investments at market value. The fair value of cash and cash equivalents in the aggregate approximate their respective carrying amounts. The fair value of investments in debt and equity securities is based upon quoted market values provided by external investment custodians (see Note 4). The fair value of long-term debt is estimated based primarily on quoted market prices of similar bonds and currently offered mortgage interest rates (see Note 8).

Determination of the fair value of student loans receivable, which are primarily federally sponsored student loans with the U.S. government mandated interest rates and repayment terms and subject to significant transfer of disposition restrictions, could not be made without incurring excessive costs.

Funds Held in Trust by Others—Funds held in trust by others represent resources neither in the possession nor under the control of the University, but are paid and administered by outside trustees, with the University deriving income or a residual interest from the assets of such funds. Funds held in trust by others are recognized at the estimated fair value of the assets or the present value of the future cash flows when the irrevocable trust is established or the University is notified of its existence.

Land, Buildings, and Equipment—Plant assets are stated at cost. Contributed assets, which are used for operations, are stated at fair market value as of the date acquired. The University also maintains a museum dedicated to pharmacy and health sciences. The value of the items contributed to the museum collection has not been capitalized.

Depreciation is provided on a straight-line basis over the estimated useful lives of the buildings (40-60 years), equipment (5-25 years), and library books and periodicals (10 years).

Maintenance repairs and minor replacements are charged to expense as incurred.

Recoverability of Long-Lived Assets—The University's assets are reviewed for impairment whenever events or circumstances provide evidence suggests that the carrying amounts may not be recoverable. When necessary, the University assesses the recoverability of its assets by determining whether the carrying value can be recovered through projected undiscounted future cash flows.

Use of Estimates—The preparation of the financial statements in conformity with generally accepted accounting principles in the United States of America 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 revenues and expenses during the reporting period. Actual results could differ from those estimates. The University has provided allowances for doubtful accounts for student accounts receivable and student loans, of \$1,320,000 and \$1,242,000 as of June 30, 2004 and 2003, respectively.

Reclassification—Certain amounts in the prior-year have been reclassified to be consistent with current-year financial statement presentation.

2. NET ASSETS

The components of the major classifications of net assets at June 30 are as follows:

	2004	2003
Unrestricted net assets:		
Unallocated	\$ 1,919,825	\$ 1,919,825
Designated for:		
Specific purposes, University's and department's	2,605,445	1,432,067
Student loans	1,858,772	1,802,993
Funds functioning as endowment	75,958,889	57,885,691
Future investment in facilities	6,139,948	16,148,151
Net investment in plant	<u>13,700,648</u>	<u>14,731,117</u>
	<u>\$ 102,183,527</u>	<u>\$ 93,919,844</u>
Temporarily restricted net assets:		
Unexpended income for instruction, scholarships		
and capital expenditures	\$ 1,487,639	\$ 2,509,539
Endowment	4,330,822	3,249,101
Annuities and unitrust	153,967	123,009
Net investment in plant	<u>60,686</u>	<u>53,603</u>
	<u>\$ 6,033,114</u>	<u>\$ 5,935,252</u>
Permanently restricted net assets:		
Student loans	\$ 281,586	\$ 279,977
Endowment	16,899,306	16,294,522
Annuities	<u>207,844</u>	<u>204,613</u>
	<u>\$ 17,388,736</u>	<u>\$ 16,779,112</u>

3. CONTRIBUTIONS RECEIVABLES

Contribution receivable consisted of the following at June 30:

	2004	2003
Contributions receivable in:		
Less than one year	\$ 351,340	\$ 57,090
One to five years	<u>986,750</u>	<u>1,133,610</u>
	1,338,090	1,190,700
Less discount to present value		
3% for 2004 and 2003	<u>(103,042)</u>	<u>(93,152)</u>
	<u>\$ 1,235,048</u>	<u>\$ 1,097,548</u>

4. INVESTMENTS

The fair and cost values of the University's investments in marketable securities by type of investment were as follows at June 30:

	2004		2003	
	Fair Value	Cost	Fair Value	Cost
Money market accounts	\$ 537,234	\$ 537,234	\$ 592,038	\$ 592,038
Corporate and other bonds	618,084	597,451	646,296	597,451
Mutual funds:				
Fixed income	30,322,634	29,963,837	26,108,198	24,865,455
Balanced	1,185,819	1,106,500	1,020,784	1,060,803
Domestic	24,394,173	21,345,217	8,487,511	7,432,838
International	10,048,819	8,722,344	8,044,820	8,998,970
Alternative and hedge	7,495,197	6,550,000	6,922,425	6,550,000
Common stocks	19,375,688	17,245,608	27,975,240	26,492,543
Private equities	187,676	193,828	81,671	110,000
Real estate limited partnership	567,680	567,680	573,141	573,141
Structured notes	2,315,000	2,000,000	2,025,000	2,000,000
Trust	463,660	448,922	425,289	448,922
	<u>\$97,511,664</u>	<u>\$89,278,621</u>	<u>\$82,902,413</u>	<u>\$79,722,161</u>

The University's investment in the real estate limited partnership is carried at cost.

For the fiscal years ended June 30, 2004 and 2003, the University incurred \$217,621 and \$230,766, respectively, in advisory and custodial fees for these investments. These fees have been netted against investment income in the Statement of Activities.

The University has a spending rule policy for the majority of the endowment fund's asset pool whereby each participating fund earns investment income on the basis of subscribed units. These units are acquired and disposed at fair market value as determined on a quarterly basis. For fiscal years ending June 30, 2004 and 2003, the income was based on a spending rate of 5.50% of the three-year trailing average market value of the related assets.

5. LAND, BUILDINGS, AND EQUIPMENT

Land, buildings, and equipment at June 30 consists of the following:

	2004	2003
Land and improvements	\$ 7,617,787	\$ 4,720,684
Buildings and improvements	88,305,249	60,234,140
Construction in progress	2,186,974	27,151,919
Equipment	9,805,366	9,417,779
Library books	4,062,740	4,062,740
	<u>111,978,116</u>	<u>105,587,262</u>
Less accumulated depreciation	<u>(45,160,892)</u>	<u>(41,835,618)</u>
	<u>\$ 66,817,224</u>	<u>\$ 63,751,644</u>

6. PENSION PLAN

The University of the Sciences in Philadelphia Basic Retirement Plan is a defined contribution pension plan covering substantially all employees. The plan is designed to provide for investments in annuities and in shares of regulated investment companies (mutual funds). The University contributes 10% of each participant's annual compensation. Pension expense was \$1,995,529 and \$2,014,610 in 2004 and 2003, respectively.

7. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

The University provides certain health care and life insurance benefits for retired employees who reach retirement age while working for the University. The University accrues for expected medical and other postretirement benefits over the years that the employees render the necessary service. The University has adopted Statement of Financial Accounting Standards ("SFAS") No. 132(R), *Employers' Disclosures about Pensions and Other Postretirement Benefits*, which revises and standardizes employers' disclosures about pension and other postretirement benefit plans but does not change the measurement of recognition of those plans.

Reconciliation of Benefit Obligation and Plan Assets

	2004	2003
Change in benefit obligation:		
Benefit obligation at June 30 of the prior year	\$ 1,214,962	\$ 1,264,939
Service cost	44,333	51,811
Interest cost	80,093	67,104
Plan participants' contributions	132,020	120,903
Actuarial (gain) loss	80,364	(149,493)
Benefit paid	(177,677)	(140,302)
Benefit obligation at end of year	<u>\$ 1,374,095</u>	<u>\$ 1,214,962</u>
Change in plan assets:		
Employer contribution	\$ 45,657	\$ 19,399
Plan participants' contributions	132,020	120,903
Benefits paid	(177,677)	(140,302)
Fair value of plan assets at end of year	<u>\$ -</u>	<u>\$ -</u>

Funded Status Reconciliation and Key Assumptions

Reconciliation of funded status:		
Funded Status	\$ (1,374,095)	\$ (1,214,962)
Unrecognized net actuarial loss	<u>267,441</u>	<u>201,164</u>
Accrued benefit cost	<u>\$ (1,106,654)</u>	<u>\$ (1,013,798)</u>
Weighted-average assumptions as of end of year:		
Discount rate	6.25%	6.00%
Expected return on plan assets	N/A	N/A
Rate of compensation increase	N/A	N/A

The assumed health care cost trend rate of the 2004 fiscal year is 8.00%. This rate was assumed to decrease gradually to 5.0% over the next six years and remain at that level thereafter.

	2004	2003
Service cost	\$ 44,333	\$ 51,811
Interest cost	80,093	67,104
Expected return on plan assets	-	-
Amortization of prior-service cost and of transition obligation	-	-
Amortization of net actuarial loss	<u>14,087</u>	<u>-</u>
Net periodic benefit cost	<u>\$ 138,513</u>	<u>\$ 118,915</u>

Sensitivity Analysis, Postretirement Benefits

The sensitivity to +1% and -1% of the health care trend rate is minimal because the medical plan includes a cap limit set by the University on post-65 benefits.

Cash Flows

Contributions - The University expects to contribute \$97,049 to its postretirement benefit plan in fiscal 2005.

Estimated Future Benefit Payments - The following benefit payments, which reflect expected future service, as appropriate, expected to be paid for the years ending June 30 are as follows:

2005	\$ 97,049
2006	98,469
2007	109,529
2008	124,284
2009	115,306
2010 - 2014	664,734

8. BONDS PAYABLE

On November 1, 1995, the Pennsylvania Higher Educational Facilities Authority (PHEFA) issued insured tax-exempt bonds totaling \$26,000,000 on behalf of the University. Proceeds were used for the advance refunding of debt for the purchase of the remaining interest in PCPS Associates, Ltd., with whom the University had leased a dormitory and for the refinancing of the partnership's debt on the facility. The remaining funds were used to finance certain capital projects and pay certain debt issuance expenses. The bonds are insured by the Municipal Bond Insurance Association and are a general obligation of the University.

On December 15, 1998, the PHEFA issued insured tax-exempt bonds totaling \$9,430,000 on behalf of the University. Proceeds were used for the demolition of various University facilities and their conversion to other University purposes and the renovation of various University facilities and the acquisition of equipment. The remaining funds were used for the refunding of debt and to pay certain debt issuance expenses. The bonds are insured by the Municipal Bond Insurance Association and are a general obligation of the University.

On May 1, 2002, the PHEFA issued tax-exempt bonds totaling \$30,000,000 on behalf of the University. Proceeds are being used for the construction and equipping of a new athletic/recreational building, a new central utility plant, and other capital projects plus the payment of certain debt issuance expenses. These variable rate bonds are secured by a letter of credit from The Bank of Nova Scotia and are a general obligation of the University.

Bonds Payable is comprised of the following at June 30:

	2004	2003
Series of 1995—4.75% to 5.40%; maturing annually to 11/01/2015	\$ 16,730,000	\$ 18,135,000
Series of 1998—3.90% to 5.25%; maturing annually to 11/01/2025	7,915,000	8,255,000
Series of 2002—Variable; maturing annually from 5/1/2017 to 5/1/2032	<u>30,000,000</u>	<u>30,000,000</u>
Total bonds payable	<u>\$54,645,000</u>	<u>\$56,390,000</u>
Unamortized issuance cost	\$ 785,830	\$ 822,754
Interest paid	\$ 1,601,365	\$ 1,741,327
Principal paid	\$ 1,745,000	\$ 1,670,000

The total market value of the \$54,645,000 PHEFA Revenue Bonds was \$55,759,315 at June 30, 2004, based on a comparison to current interest rates.

The maturities of all bonds and term loan for the next five years ending June 30 are:

Year	Maturing	Remarketed Debt	Total
2005	\$ 1,825,000	\$ -	\$ 1,825,000
2006	1,905,000		1,905,000
2007	1,845,000		1,845,000
2008	1,945,000		1,945,000
2009	2,045,000		2,045,000
Thereafter	15,080,000	30,000,000	45,080,000

The Series of 2002 bonds have remarketing terms and a related standby letter of credit that could change the maturity date based on the current terms and expiration of the letter of credit. If the standby letter of

credit is drawn upon and is not repaid within 180 days, it will convert to a term loan that is due to be repaid in four equal installments over a two-year period from the date of advance. The Series of 2002 bonds have been included in the above table based on their stated maturity date.

The University has an available line of credit in the amount of \$1.5 million with no specific amount required for compensating balance and no outstanding liability as of June 30, 2004.

SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, permit the extinguishment of liabilities only through payment of the creditor and relief of the obligation for the liability or if the debtor is legally released from the obligation. Because no debt obligations were defeased by the University during the 2004 or 2003 fiscal years, the provisions of this statement were not applicable to the University. The University has adopted the statement and will adhere to its provisions prospectively. The University's outstanding debt that had been refunded prior to 1998 and was not required to be disclosed on the statement of financial position totaled \$395,000 and \$1,145,000 at June 30, 2004 and 2003, respectively. Funds held by a trustee to repay these obligations totaled \$408,418 and \$1,208,667 at June 30, 2004 and 2003, respectively.

9. COMMITMENTS AND CONTINGENCIES

The University has noncancelable operating leases ending in 2007 through 2029 for certain facilities and equipment. Rental expense under these agreements equaled \$246,966 in 2004 and \$148,704 in 2003. Future minimum lease payments are as follows: 2005--\$657,675; 2006--\$803,199; 2007--\$539,633; 2008--\$507,494; 2009--\$466,020; and thereafter--\$4,704,251

The University has multiyear management contracts for facilities and capital programs. Expenses and capitalized costs under these agreements equaled \$1,114,132 in 2004 and \$1,170,412 in 2003. Future minimum payments are as follows: 2005--\$974,940; 2006--\$974,940; and 2007--\$927,025.

In the ordinary course of the University's educational activities, various lawsuits, claims and other contingencies arise. While the ultimate disposition of the aforementioned contingencies is not determinable at this time, management believes that any liability resulting there from will not materially affect the financial position of the University as of June 30, 2004.

10. INTERNAL REVENUE CODE STATUS

The University has been granted tax-exempt status as a nonprofit organization under Section 501(c)(3) of the Internal Revenue Code and, accordingly, files federal tax form 990 (Return of Organization Exempt from Income Tax) annually.

11. RELATED PARTY TRANSACTIONS

A member of the University's Board of Trustees is a partner of the University's outside legal counsel. The University paid \$318,487 and \$291,678 to this legal firm for its services for the years ended June 30, 2004 and 2003, respectively.

12. OPERATING EXPENSES

Expenses by natural classifications for the years ended June 30 were:

	2004	2003
Compensation:		
Salaries	\$27,667,916	\$24,955,993
Employee benefits	<u>7,858,693</u>	<u>7,528,383</u>
Total compensation	<u>35,526,609</u>	<u>32,484,376</u>
Other expenses:		
Depreciation of buildings and equipment	3,325,274	2,805,405
Utilities	1,855,438	1,396,352
Printing	1,161,418	1,285,585
Advertising and consulting	1,999,662	1,838,696
Interest on indebtedness	1,495,915	1,555,888
Scholarships	1,127,508	772,460
Clinical fees	1,086,048	1,026,218
Food	970,951	862,027
Management contracts	734,301	677,638
Insurance	693,018	490,420
Computer equipment and software	894,570	570,648
Reference materials	708,654	651,830
Other supplies and expenses	<u>8,946,561</u>	<u>7,849,752</u>
Total other expenses	<u>24,999,317</u>	<u>21,782,919</u>
Total expenses	<u>\$60,525,925</u>	<u>\$54,267,195</u>

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