

# UNIVERSITY OF THE SCIENCES IN PHILADELPHIA AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

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### 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 2004 term, the University enrolled approximately 2,824 students, which is equivalent to 2,587 full-time students or 2,406 undergraduates and first-degree students plus 181 graduates and other program majors. The undergraduate classes’ primary areas of study are doctor of pharmacy at 67%, and physical therapy at 6%.

Effective July 1, 2004, the University established ACI, LLC to provide continuing education, research and formulary review services for the private sector. These services were previously provided by a department within the University. As of January 1, 2005, the University resumed providing most of these services directly rather than offering them through the subsidiary.

**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, changes in the fair value of the interest rate swap contract, loss on bond refinancing, 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 Consolidated 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 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.

***Beneficial Interest in Trusts***—These funds 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. They 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 suggesting 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 \$1,599,000 and \$1,320,000 as of June 30, 2005 and 2004, respectively.

***Accounting for Derivative Instruments and Hedging Activities***—The University accounts for derivative instruments in accordance with Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS No. 133, as amended, establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that an entity recognize all derivative instruments as either assets or liabilities and measure them at fair value.

***Principles of Consolidation***—The consolidated financial statements include the accounts of the University and its subsidiary. All intercompany balances and transactions have been eliminated.

***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:

	<b>2005</b>	<b>2004</b>
Unrestricted net assets:		
Unallocated	\$ 1,919,825	\$ 1,919,825
Designated for:		
Specific purposes, University's and department's	968,940	2,605,445
Student loans	1,872,598	1,858,772
Valuation change in interest rate swap contract	(1,887,651)	-
Funds functioning as endowment	81,838,557	75,958,889
Future investment in facilities	6,951,029	6,139,948
Net investment in plant	<u>12,675,400</u>	<u>13,700,648</u>
	<u>\$ 104,338,698</u>	<u>\$ 102,183,527</u>
Temporarily restricted net assets:		
Unexpended income for instruction, scholarships		
and capital expenditures	\$ 2,052,844	\$ 1,487,639
Endowment	4,771,180	4,330,822
Annuities and unitrust	71,992	153,967
Net investment in plant	<u>-</u>	<u>60,686</u>
	<u>\$ 6,896,016</u>	<u>\$ 6,033,114</u>
Permanently restricted net assets:		
Student loans	\$ 282,047	\$ 281,586
Endowment	29,786,054	16,899,306
Annuities	<u>103,350</u>	<u>207,844</u>
	<u>\$ 30,171,451</u>	<u>\$ 17,388,736</u>

## 3. CONTRIBUTIONS RECEIVABLES

Contribution receivable consisted of the following at June 30:

	<b>2005</b>	<b>2004</b>
Contributions receivable in:		
Less than one year	\$ 4,727,302	\$ 351,340
One to five years	<u>649,750</u>	<u>986,750</u>
	5,377,052	1,338,090
Less discount to present value		
3% for 2005 and 2004	<u>(78,946)</u>	<u>(103,042)</u>
	<u>\$ 5,298,106</u>	<u>\$ 1,235,048</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:

	2005		2004	
	Fair Value	Cost	Fair Value	Cost
Money market accounts	\$ 3,713,743	\$ 3,713,743	\$ 537,234	\$ 537,234
Corporate and other bonds	100,714	100,066	618,084	597,451
Mutual funds:				
Fixed income	25,092,567	24,443,808	30,322,634	29,963,837
Balanced	11,104,866	11,017,135	1,185,819	1,106,500
Domestic	28,226,291	23,641,216	24,394,173	21,345,217
International	14,057,161	11,349,840	10,048,819	8,722,344
Alternative and hedge	19,121,586	17,446,300	7,495,197	6,550,000
Common stocks	9,280,172	8,582,549	19,375,688	17,245,608
Private equities	372,607	399,337	187,676	193,828
Real estate limited partnership	586,633	601,504	567,680	567,680
Structured notes	-	-	2,315,000	2,000,000
	<u>\$ 111,656,340</u>	<u>\$ 101,295,498</u>	<u>\$ 97,048,004</u>	<u>\$ 88,829,699</u>

For the fiscal years ended June 30, 2005 and 2004, the University incurred \$239,150 and \$217,621, respectively, in advisory and custodial fees for these investments. These fees have been netted against investment income in the Consolidated 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, 2005 and 2004, the income was based on a spending rate of 5.5% 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:

	2005	2004
Land and improvements	\$ 7,623,887	\$ 7,617,787
Buildings and improvements	89,026,155	88,305,249
Construction in progress	9,716,602	2,186,974
Equipment	10,635,938	9,805,366
Library books	<u>4,062,740</u>	<u>4,062,740</u>
	121,065,322	111,978,116
Less accumulated depreciation	<u>(48,474,452)</u>	<u>(45,160,892)</u>
	<u>\$ 72,590,870</u>	<u>\$ 66,817,224</u>

## 6. PENSION AND DEFERRED COMPENSATION PLANS

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 \$2,112,259 and \$1,995,529 in 2005 and 2004, respectively.

In fiscal year 2005, the University began to offer key employees the opportunity to participate in nonqualified, tax-deferred compensation plans.

## 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 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

	2005	2004
Change in benefit obligation:		
Benefit obligation at June 30 of the prior year	\$ 1,374,095	\$ 1,214,962
Service cost	38,772	44,333
Interest cost	91,227	80,093
Plan participants' contributions	99,105	132,020
Actuarial (gain) loss	299,470	80,364
Benefit paid	<u>(213,280)</u>	<u>(177,677)</u>
Benefit obligation at end of year	<u>\$ 1,689,389</u>	<u>\$ 1,374,095</u>
Change in plan assets:		
Employer contribution	\$ 114,175	\$ 45,657
Plan participants' contributions	99,105	132,020
Benefits paid	<u>(213,280)</u>	<u>(177,677)</u>
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	\$ (1,689,389)	\$ (1,374,095)
Unrecognized net actuarial loss	<u>550,507</u>	<u>267,441</u>
Accrued benefit cost	<u>\$ (1,138,882)</u>	<u>\$ (1,106,654)</u>
Weighted-average assumptions as of end of year:		
Discount rate	5.25%	6.25%
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 2005 fiscal year is 7.5%. This rate was assumed to decrease gradually to 5% over the next six years and remain at that level thereafter.

	<b>2005</b>	<b>2004</b>
Service cost	\$ 38,772	\$ 44,333
Interest cost	91,227	80,093
Expected return on plan assets	-	-
Amortization of prior-service cost and of transition obligation	-	-
Amortization of net actuarial loss	<u>16,404</u>	<u>14,087</u>
Net periodic benefit cost	<u>\$ 146,403</u>	<u>\$ 138,513</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 \$130,690 to its postretirement benefit plan in fiscal 2006.

**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:

2006	\$ 130,690
2007	116,552
2008	125,556
2009	107,509
2010	107,274
2011-2015	552,498

On December 8, 2003 the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the “Act”) became law. This Act introduced a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that meets creditable coverage/financing definitions defined by the Centers of Medicare and Medicaid Services. There is no Medicare Part D impact on the University’s plan given the limited nature of the post-65 obligation.

**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. In fiscal year 2005 these bonds were refunded with proceeds from the 2005 PHEFA bonds.

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. In fiscal year 2005 these bonds were refunded with proceeds from the 2005 PHEFA bonds.

On May 1, 2002, the PHEFA issued tax-exempt bonds totaling \$30,000,000 on behalf of the University. Proceeds were used for the construction and equipping of a new athletic/recreational center, a new central utility plant, and other capital projects plus the payment of certain debt issuance expenses. In fiscal year 2005 these variable rate bonds were redeemed with proceeds from the 2005 PHEFA bonds.

On January 15, 2005, the PHEFA issued 2005A tax-exempt bonds totaling \$40,545,000 and on February 1, 2005, the PHEFA issued 2005B tax-exempt bonds totaling \$54,475,000 and 2005C taxable bonds totaling \$9,375,000 on behalf of the University. Proceeds are being used to establish refunding escrows for the 1995 and 1998 PHEFA bonds, to redeem 2002 PHEFA bonds, for the construction and equipping of a new science and technology center, the expansion of the central utility plant, and other capital projects plus the payment of capital interest expense and certain debt issuance expenses. These bonds are insured by XL Capital Insurance and are secured by a mortgage on the science and technology center. The 2005A PHEFA bonds are fixed rate instruments while the 2005B and 2005C PHEFA bonds are auction rate certificates ("ARC"). The interest rates on the 2005B PHEFA and 2005C PHEFA were 2.15% and 3.3% at June 30, 2005, respectively.

In the event an auction is not held or the auction agent is unable to collect sufficient clearing bids for the ARC holders wishing to sell, the auction may be suspended, at which time the interest rate for the 2005B and 2005C PHEFA bonds becomes 15% and 18%, respectively. In the event this occurs, the University retains the right, as prescribed in the applicable bond documents, to elect to convert all of the 2005B or 2005C PHEFA bonds from one type of interest rate period (other than from a fixed rate) to another type of interest rate period, as prescribed in the applicable bond documents.

Concurrent with the issuance of the 2005B PHEFA bonds, the University entered into a variable-to fixed interest rate swap agreement with UBS AG that converts \$30,325,000 of the 2005B PHEFA bonds to a fixed rate of 3.53%. The swap agreement was effective on February 2, 2005 and has a maturity date of November 1, 2031. For the year ended June 30, 2005, the agreement resulted in the losses of \$1,887,651, representing the change in the fair value of this arrangement.

Bonds Payable is comprised of the following at June 30:

	2005	2004
Series of 1995—refunded 2/1/2005	\$ -	\$ 16,730,000
Series of 1998—refunded 2/1/2005		7,915,000
Series of 2002—redeemed 2/1/2005		30,000,000
Series of 2005A—3% to 5%; maturing annually to 11/1/2025, and on 11/1/2033 and 11/1/2036	40,545,000	
Series of 2005A net premium	766,521	
Series of 2005B—variable and synthetically fixed; maturing 11/1/2031	54,475,000	
Series of 2005C—taxable variable, maturing 11/1/2015	<u>9,375,000</u>	<u>                    </u>
Total bonds payable	<u>\$ 105,161,521</u>	<u>\$ 54,645,000</u>
Unamortized issuance cost	\$ 2,465,641	\$ 785,830
Interest paid	\$ 2,502,818	\$ 1,601,365
Principal paid	\$ 54,645,000	\$ 1,745,000

The total market value of the \$104,395,000 PHEFA Revenue Bonds was \$106,028,947 at June 30, 2005, 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	Debt Service Fund	Total
2006	\$ 615,000	\$ 1,450,000	\$ 2,065,000
2007	860,000	1,250,000	2,110,000
2008	885,000	1,300,000	2,185,000
2009	580,000	1,350,000	1,930,000
2010	620,000	1,375,000	1,995,000
Thereafter	36,985,000	57,125,000	94,110,000

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, 2005 or 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. As noted above, the University refunded the Series of 1995 and Series of 1998 with proceeds from the Series of 2005. This outstanding debt along with any other debt that had been refunded prior to June 30, 2005 and was not required to be disclosed on the statement of financial position totaled \$22,820,000 and \$395,000 at June 30, 2005 and 2004, respectively. Funds held by a trustee to repay these obligations totaled \$23,495,448 and \$408,418 at June 30, 2005 and 2004, 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 \$829,391 in 2005 and \$246,966 in 2004. Future minimum lease payments are as follows: 2006--\$856,398; 2007--\$599,861; 2008--\$538,416; 2009--\$468,764; 2010--\$478,598; and thereafter--\$4,229,113.

The University has multiyear management contracts for facilities and capital programs. Expenses and capitalized costs under these agreements equaled \$976,334 in 2005 and \$1,114,132 in 2004. Future minimum payments are as follows: 2006--\$974,940 and 2007--\$927,025. This entity also provided shuttle services which cost \$119,340 in 2005 and \$113,824 in 2004.

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, 2005.

## **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 \$591,566 and \$318,487 to this legal firm for its services for the years ended June 30, 2005 and 2004, respectively.

## 12. OPERATING EXPENSES

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

	2005	2004
Compensation:		
Salaries	\$ 30,030,251	\$ 27,667,916
Employee benefits	<u>8,743,388</u>	<u>7,858,693</u>
Total compensation	<u>38,773,639</u>	<u>35,526,609</u>
Other expenses:		
Depreciation of buildings and equipment	3,313,560	3,325,274
Interest on indebtedness	2,472,899	1,495,915
Advertising and consulting	1,932,272	1,999,662
Utilities	1,875,315	1,855,438
Printing	1,163,640	1,161,418
Rental	1,088,430	474,237
Clinical fees	1,073,246	1,086,048
Scholarships	1,021,672	1,127,508
Food	989,676	970,951
Computer equipment and software	813,926	894,570
Reference materials	751,002	708,654
Management contracts	695,714	734,301
Other supplies and expenses	<u>8,915,583</u>	<u>9,165,340</u>
Total other expenses	<u>26,106,935</u>	<u>24,999,316</u>
Total expenses	<u>\$ 64,880,574</u>	<u>\$ 60,525,925</u>

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