



The Pennsylvania Higher Education Foundation, Inc.

Consolidated Annual Financial Report

May 31, 2003



30 North Third Street
Suite 200
PO Box 1190
Harrisburg, PA 17108-1190

Independent Auditors' Report

The Board of Directors
The Pennsylvania Higher Education
Foundation, Inc.:

We have audited the accompanying consolidated statements of financial position of The Pennsylvania Higher Education Foundation, Inc. (the Foundation) as of May 31, 2003 and 2002, and the related consolidated statements of activities and cash flows for the year ended May 31, 2003 and for the period from June 22, 2001 (date of inception) through May 31, 2002. These consolidated financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of May 31, 2003 and 2002, and the results of its activities and its cash flows for the year ended May 31, 2003 and for the period from June 22, 2001 (date of inception) through May 31, 2002 in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

August 15, 2003



KPMG LLP, KPMG LLP, a U.S. limited liability partnership, is
a member of KPMG International, a Swiss association.

The Pennsylvania Higher Education Foundation, Inc.
 Consolidated Statements of Financial Position
 May 31



	2003	2002
Assets:		
Cash	\$ 443	21,658
Savings and temporary cash investments	26,644,514	13,024,850
Prepaid expenses	4,550	-
Office furnishings and equipment, net of accumulated depreciation	117,702	-
Total assets	\$ 26,767,209	13,046,508
Liabilities and net assets:		
Liabilities:		
Accrued expenses	\$ 452	-
Net assets:		
Temporarily restricted	26,766,757	13,046,508
Total liabilities and net assets	\$ 26,767,209	13,046,508

See accompanying notes to consolidated financial statements.

The Pennsylvania Higher Education Foundation, Inc.
 Consolidated Statements of Activities
 For the year ended May 31, 2003 and the period from June 22, 2001
 (date of inception) through May 31, 2002



	2003	2002
Changes in unrestricted net assets:		
Net assets released from restrictions	\$ 349,585	-
Expenses:		
Nursing Education Initiative	17,140	-
Other program grants	7,500	-
Management and general	311,107	-
Fundraising	13,838	-
Total expenses	<u>349,585</u>	<u>-</u>
Net change in unrestricted net assets	-	-
Changes in temporarily restricted net assets:		
Contributions	13,474,589	13,024,850
Income on investments	595,245	21,658
Net assets released from restrictions	<u>(349,585)</u>	<u>-</u>
Increase in temporarily restricted net assets	<u>13,720,249</u>	<u>13,046,508</u>
Increase in net assets	13,720,249	13,046,508
Net assets at beginning of year	<u>13,046,508</u>	<u>-</u>
Net assets at end of year	<u>\$ 26,766,757</u>	<u>13,046,508</u>

See accompanying notes to consolidated financial statements.

The Pennsylvania Higher Education Foundation, Inc.
Consolidated Statements of Cash Flows
For the year ended May 31, 2003 and the period from June 22, 2001
(date of inception) through May 31, 2002



	2003	2002
Cash flows from operating activities:		
Cash received from contributors	\$ 13,083,895	13,024,850
Investment income received	595,245	21,658
Grants paid	(7,500)	-
Cash paid for management, general and fundraising expenses	(29,038)	-
Net cash provided by operating activities	13,642,602	13,046,508
Cash flows from investing activities:		
Purchase of investments	(13,619,664)	(13,024,850)
Cash flows from financing activities:		
Purchase of office furnishings and equipment	(44,153)	-
Net change in cash	(21,215)	21,658
Cash at beginning of year	21,658	-
Cash at end of year	\$ 443	21,658
Reconciliation of change in net assets to net cash provided by operating activities:		
Change in net assets	\$ 13,720,249	13,024,850
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Depreciation	4,346	-
Increase in other assets	(4,550)	-
Increase in accrued expenses	452	-
Gifts of office furnishings and equipment	(77,895)	-
Net cash provided by operating activities	\$ 13,642,602	13,024,850

See accompanying notes to consolidated financial statements.



1. Organization and Operation

The Pennsylvania Higher Education Foundation, Inc. ("PHEF" or the "Foundation"), a not-for-profit organization, was formed on June 22, 2001. Its charitable purposes include, but are not limited to, activities intended to improve or enhance postsecondary educational opportunities for students in Pennsylvania and elsewhere. It may fulfill its purposes by assisting students in meeting their expenses of higher education by providing assistance in the form of grants, loans or scholarships. It may also enable lenders and postsecondary institutions to make loans or other financial assistance available to students and parents for postsecondary educational purposes and by providing such other assistance to students, parents and educational institutions as will improve or enhance postsecondary educational opportunities.

Pennsylvania Higher Education Assistance Agency ("PHEAA"), a component unit of the Commonwealth of Pennsylvania, supported the formation of the Foundation and paid for the costs of creating the Foundation. The organization is tax-exempt under Section 501(c)(3) of the Internal Revenue Code.

2. Related Entity and Related Party Transactions

A majority of the directors of the Foundation are also members of PHEAA's Executive Committee. As such, transactions between PHEAA and the Foundation are related party transactions.

The Foundation received its initial funding of \$13,024,850 from PHEAA in May 2002. PHEAA has also made a non-binding commitment to support future operations of the Foundation by transferring up to an additional \$40 million before June 30, 2006 and may support the operations of the Foundation by donating operational and system support. PHEAA may decline to donate at any time if it determines that making such donations would not be in its best interests. Because the commitment is non-binding and undetermined, a receivable has not been recorded in the accompanying consolidated financial statements.

During the year ended May 31, 2003, PHEAA made a cash donation of \$13,083,895. Additionally, PHEAA provided operational support valued at \$312,799 and office furnishings and equipment valued at \$77,895. The value of office space donated by PHEAA was estimated based upon the cost of comparable office space in the Harrisburg, PA market. Otherwise, the value of operational support and office furnishings and equipment was valued at PHEAA's actual cost, which PHEAA provided to the Foundation.

3. Summary of Significant Accounting Policies

(a) Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and are presented pursuant to Financial Accounting Standards Board Statement No. 117, *Financial Statements of Not-for-Profit Organizations*.

(b) Consolidation

The consolidated financial statements include the accounts of PHEF and The Higher Education Foundation, Inc., ("HEF") a not-for-profit organization. HEF was also formed on June 22, 2001, its charitable purpose is to operate exclusively for the benefit of PHEF and the directors of PHEF are directors of HEF. HEF was formed to assist with fundraising and program administration particularly for projects that may extend beyond Pennsylvania. All significant intercompany transactions and balances are eliminated in consolidation.

(c) Investments

Investments are reported at fair value using amounts reported by the institution holding the investment.



(d) Office Furnishings and Equipment

Office furnishings and equipment are reported at cost net of depreciation. Depreciation is calculated on the straight-line method over the estimated useful life of the asset. Estimated useful lives of office furnishings and equipment range from 5 to 25 years.

(e) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

4. Net Assets

The Foundation classifies its net assets into three categories as follows:

- Permanently restricted – net assets resulting from contributions and other inflows of assets whose use is limited by donor-imposed stipulations that neither expire by the passage of time nor can be fulfilled or otherwise removed by actions of the Foundation.
- Temporarily restricted – net assets resulting from contributions and other inflows of assets whose use is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions pursuant to those stipulations.
- Unrestricted – Net assets that are neither permanently restricted nor temporarily restricted by donor-imposed stipulations.

At May 31, 2003, all net assets of the Foundation, amounting to \$26,766,757, are temporarily restricted for activities that further PHEAA's statutory purpose.

5. Tax Status

The Internal Revenue Service ("IRS") has determined and informed the Foundation by a letter dated August 8, 2001 that the Foundation is exempt from federal income tax under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3). The Foundation will be considered a publicly supported organization for federal income tax purposes through May 31, 2006, at which time the IRS will consider whether the Foundation has met the requirements to be considered a publicly supported organization or whether it must be classified as a private foundation for future periods.

6. Investments

Investments at May 31, 2003 and 2002 were as follows:

		2003	2002
Commonwealth of Pennsylvania State Treasury short-term investment pool	\$	26,222,846	13,024,850
Savings account		421,668	-
	\$	<u>26,644,514</u>	<u>13,024,850</u>



7. Office Furnishings and Equipment

Office furnishings and equipment at May 31, 2003 and 2002 were as follows:

	2003	2002
Office furnishings and office equipment	\$ 77,895	-
Vehicle	44,153	-
	<u>122,048</u>	-
Less accumulated depreciation	<u>(4,346)</u>	-
	<u>\$ 117,702</u>	-

8. Subsequent Event

On June 26, 2003, PHEAA made a cash donation of \$10,000,000 to the Foundation.

9. Commitments and Contingencies

The Foundation created the Nursing Education Initiative to provide a new source of financial support to schools and students. The intent of the program is to encourage additional students to pursue nursing as an academic and professional choice. For the 2003-04 program year, the Foundation has received 83 applications and grant proposals that, if approved by the Board of Directors, will result in grants of approximately \$4,074,000. Ten other education organizations have indicated intent to submit a proposal that, if submitted and approved, could increase the program cost to approximately \$4,577,000. Assuming approval, the Foundation expects that these grants will be paid by May 31, 2004. In addition, the Foundation has committed up to \$2 million in matching funds for the 2003-04 academic year to encourage other organizations and individuals to provide scholarship funds for nursing students.