



The Pennsylvania Higher Education Foundation, Inc.

Consolidated Annual Financial Report

May 31, 2004



KPMG LLP
Suite 200
30 North Third Street
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, 2004 and 2003, and the related consolidated statements of activities and cash flows for the years ended May 31, 2004 and 2003. 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, 2004 and 2003, and the results of its activities and its cash flows for the years the ended in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

September 15, 2004

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



	2004	2003
Assets:		
Cash	\$ 477	443
Short-term investments	537,014	26,644,514
Prepaid expenses	5,700	4,550
Long-term investments	34,566,181	-
Office furnishings and equipment, net of accumulated depreciation	129,825	117,702
Total assets	\$ 35,239,197	26,767,209
Liabilities and net assets:		
Liabilities:		
Accrued expenses	\$ 1,838	452
Amounts payable to specific organizations as designated by donors	1,413,333	-
Total liabilities	1,415,171	452
Net assets:		
Unrestricted	5,859	-
Temporarily restricted	33,818,167	26,766,757
Total net assets	33,824,026	26,766,757
Total liabilities and net assets	\$ 35,239,197	26,767,209

See accompanying notes to consolidated financial statements.

The Pennsylvania Higher Education Foundation, Inc.
Consolidated Statements of Activities
For the years ended May 31



	2004	2003
Changes in unrestricted net assets:		
Revenues:		
Income on long-term investments	\$ 1,602	-
Net unrealized and realized gains on long-term investments	4,257	-
Total revenues	5,859	-
Net assets released from restrictions	6,321,976	349,585
Increase in unrestricted net assets	6,327,835	349,585
Expenses:		
Nursing Education Initiative	5,537,764	17,140
Other program grants	2,500	7,500
Management and general	699,502	311,107
Fundraising	82,210	13,838
Total expenses	6,321,976	349,585
Net change in unrestricted net assets	5,859	-
Changes in temporarily restricted net assets:		
Contributions	11,010,924	13,474,589
Income on short-term investments	2,358,189	595,245
Income on long-term investments	30,498	-
Net unrealized and realized gains on long-term investments	(26,225)	-
Net assets released from restrictions	(6,321,976)	(349,585)
Increase in temporarily restricted net assets	7,051,410	13,720,249
Increase in net assets	7,057,269	13,720,249
Net assets at beginning of year	26,766,757	13,046,508
Net assets at end of year	\$ 33,824,026	26,766,757

See accompanying notes to consolidated financial statements.

The Pennsylvania Higher Education Foundation, Inc.
Consolidated Statements of Cash Flows
For the years ended May 31



	2004	2003
Cash flows from operating activities:		
Cash received from donors	\$ 11,643,248	13,083,895
Investment income received	2,390,289	595,245
Grants paid	(5,444,508)	(7,500)
Cash paid for management, general, and fundraising expenses	(110,871)	(29,038)
Net cash provided by operating activities	8,478,158	13,642,602
Cash flows from investing activities:		
Proceeds from sale or maturities of long-term investments	9,550,258	-
Purchase of long-term investments	(44,138,407)	-
Proceeds from sales or maturities of short-term investments	38,465,688	576,135
Purchases of short-term investments	(12,358,188)	(14,195,799)
Net cash provided by investing activities	(8,480,649)	(13,619,664)
Cash flows from financing activities:		
Investment in office furnishings and equipment	2,525	(44,153)
Net change in cash	34	(21,215)
Cash at beginning of year	443	21,658
Cash at end of year	\$ 477	443
Reconciliation of change in net assets to net cash provided by operating activities:		
Change in net assets	\$ 7,057,269	13,720,249
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Depreciation	20,929	4,346
Unrealized (gains) losses on long-term investments retained	(11,337)	-
Losses on sales of long-term investments	33,305	-
Increase in other assets	(1,150)	(4,550)
Increase in accrued expenses	1,386	452
Increase in amounts payable to specific organizations as designated by donors	1,413,333	-
Gifts of office furnishings and equipment	(35,577)	(77,895)
Net cash provided by operating activities	\$ 8,478,158	13,642,602

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.

During the year ended May 31, 2004, PHEAA made a cash donation of \$10,000,000. Additionally, PHEAA provided operational support valued at \$745,432 and office furnishings and equipment valued at \$35,577. 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. All support provided by PHEAA is classified as temporarily restricted gifts since the charitable purposes of PHEF are broader than PHEAA's statutory purposes.

PHEAA has also made a non-binding commitment to support future operations of the Foundation by transferring up to an additional \$30 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 contribution receivable has not been recorded in the accompanying consolidated financial statements.

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, and 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.

The Pennsylvania Higher Education Foundation, Inc.

Notes to Consolidated Financial Statements
For the years ended May 31, 2004 and 2003



(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) Donor-restricted contributions

Contributions that are restricted by the donor are reported as increases in temporarily or permanently restricted net assets, depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as temporarily restricted net assets and reclassified to unrestricted net assets in the statement of activities as net assets released from restriction.

(f) 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.

Net assets at May 31, 2004 consist of the following:

	2004	2003
Unrestricted	\$ 5,859	-
Temporarily restricted:		
Nursing education initiative	207,415	-
Post-secondary educational purposes	33,610,752	26,766,757
Total temporarily restricted	<u>33,818,167</u>	<u>26,766,757</u>
Total net assets	<u>\$ 33,824,026</u>	<u>26,766,757</u>



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 and Investment Income (Loss)

Investments at May 31, 2004 and 2003 were as follows:

	2004	2003
Short-term:		
Commonwealth of Pennsylvania State Treasury short-term investment pool	\$ 212,729	26,222,846
Savings account	324,285	421,668
	<u>537,014</u>	<u>26,644,514</u>
Long-term:		
Equity mutual funds	197,044	-
Equity investments	1,505,063	-
Fixed income funds	796,797	-
Cash and money market securities	32,067,277	-
	<u>34,566,181</u>	<u>-</u>
	<u>\$ 35,103,195</u>	<u>26,644,514</u>

Investment income (losses) for the years ended May 31, 2004 and 2003 were as follows:

	2004	2003
Short-term:		
Interest	\$ 2,358,189	595,245
Long-term:		
Interest and dividends	32,100	-
Net realized and unrealized gains	(21,968)	-
	<u>10,132</u>	<u>-</u>
	<u>\$ 2,368,321</u>	<u>595,245</u>



7. Office Furnishings and Equipment

Office furnishings and equipment at May 31, 2004 and 2003 were as follows:

		2004	2003
Office furnishings and office equipment	\$	113,472	77,895
Vehicle		41,628	44,153
		155,100	122,048
Less accumulated depreciation		(25,275)	(4,346)
	\$	129,825	117,702

8. Agency Transactions

The Foundation received \$1,413,333 of donations for which the donor is involved in directing the donation to specified organizations that qualified for Foundation programs. At May 31, 2004, none of these donations have been transferred to the specified organizations. Accordingly, these transactions are considered agency transactions, the donated amount is recorded as a liability in the consolidated statement of financial position, and the Foundation did not recognize contribution revenue and will not recognize a program expense when the donations are transferred to the recipients.

9. Subsequent Event

On June 25, 2004, PHEAA made a cash donation of \$10,000,000 to the Foundation.

10. 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 2004-05 program year, the Foundation has received 110 applications and grant proposals that, if approved by the Board of Directors, will result in grants of approximately \$8,670,500. Included within this amount are agency transactions for \$1,413,333. This amount may also include donor contributions to the Nursing Education Grant Program and the various donor component programs within the Pennsylvania Nursing Assistance Program. Assuming approval, the Foundation expects that these grants will be paid by May 31, 2005. In addition, the Foundation has committed up to \$2,250,000 in matching funds for the 2004-05 academic year to encourage other organizations and individuals to provide scholarship funds for nursing students and \$1,000,000 for a career awareness campaign.