



**The Pennsylvania Higher Education Foundation, Inc.**

**Consolidated Annual Financial Report**

**May 31, 2005**



**KPMG LLP**  
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## **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, 2005 and 2004, and the related consolidated statements of activities and cash flows for the years then ended. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control over financial reporting. Accordingly, we express no such opinion. 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, 2005 and 2004, and the results of its activities and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

**KPMG LLP**

August 10, 2005

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



	2005	2004
<b>Assets:</b>		
Cash	\$ 874	477
Short-term investments	188,789	537,014
Prepaid expenses	5,828	5,700
Pledges receivable, net of discount	19,709	-
Long-term investments	39,399,606	34,566,181
Office furnishings and equipment, net of accumulated depreciation	112,427	129,825
<b>Total assets</b>	<b>\$ 39,727,233</b>	<b>35,239,197</b>
<b>Liabilities and net assets:</b>		
<b>Liabilities:</b>		
Accrued expenses	\$ 327,875	1,838
Amounts payable to specific organizations as designated by donors	1,102,500	1,413,333
<b>Total liabilities</b>	<b>1,430,375</b>	<b>1,415,171</b>
<b>Net assets:</b>		
Unrestricted	59,204	5,859
Temporarily restricted	38,237,654	33,818,167
<b>Total net assets</b>	<b>38,296,858</b>	<b>33,824,026</b>
<b>Total liabilities and net assets</b>	<b>\$ 39,727,233</b>	<b>35,239,197</b>

See accompanying notes to consolidated financial statements.

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



	2005	2004
Changes in unrestricted net assets:		
Revenues:		
Income on long-term investments	\$ 14,823	1,602
Net unrealized and realized gains (losses) on long-term investments	38,522	4,257
Total revenues	53,345	5,859
Net assets released from restrictions	11,722,552	6,321,976
Increase in unrestricted net assets	11,775,897	6,327,835
Expenses:		
Nursing Education Initiative	10,167,024	5,537,764
Other program grants	-	2,500
Management and general	1,109,533	699,502
Fundraising	445,995	82,210
Total expenses	11,722,552	6,321,976
Net change in unrestricted net assets	53,345	5,859
Changes in temporarily restricted net assets:		
Contributions	14,248,013	11,010,924
Income on short-term investments	2,162	2,358,189
Income on long-term investments	743,136	30,498
Net unrealized and realized gains (losses) on long-term investments	1,148,728	(26,225)
Net assets released from restrictions	(11,722,552)	(6,321,976)
Increase in temporarily restricted net assets	4,419,487	7,051,410
Increase in net assets	4,472,832	7,057,269
Net assets at beginning of year	33,824,026	26,766,757
Net assets at end of year	\$ 38,296,858	33,824,026

See accompanying notes to consolidated financial statements.

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



	2005	2004
Cash flows from operating activities:		
Cash received from donors	\$ 13,016,450	11,643,248
Investment income received	760,121	2,390,289
Grants paid	(9,084,573)	(5,444,508)
Cash paid for management, general, and fundraising expenses	(1,393,238)	(110,871)
Net cash provided by operating activities	3,298,760	8,478,158
Cash flows from investing activities:		
Proceeds from sales or maturities of long-term investments	77,091,197	9,550,258
Purchases of long-term investments	(80,737,372)	(44,138,407)
Proceeds from sales or maturities of short-term investments	710,227	38,465,688
Purchases of short-term investments	(362,002)	(12,358,188)
Net cash provided by investing activities	(3,297,950)	(8,480,649)
Cash flows from financing activities:		
Investment in office furnishings and equipment, net of refunds	(413)	2,525
Net change in cash	397	34
Cash at beginning of year	477	443
Cash at end of year	\$ 874	477
Reconciliation of change in net assets to net cash provided by operating activities:		
Change in net assets	\$ 4,472,832	7,057,269
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Depreciation	22,923	20,929
Unrealized (gains) losses on long-term investments Retained	(1,023,606)	(11,337)
Realized (gains) losses on sales of long-term Investments	(163,644)	33,305
Increase in pledges receivable, net of discount	(19,709)	-
Increase in prepaid expenses	(128)	(1,150)
Increase in accrued expenses	326,037	1,386
Increase (decrease) in amounts payable to specific organizations as designated by donors	(310,833)	1,413,333
Gifts of office furnishings and equipment	(5,112)	(35,577)
Net cash provided by operating activities	\$ 3,298,760	8,478,158

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 Foundation 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.

During the year ended May 31, 2005, PHEAA made a cash donation of \$10,060,000. Additionally, PHEAA provided donated services valued at \$2,361,742 and gifts of office furnishings and equipment valued at \$5,112. During the year ended May 31, 2004, PHEAA made a cash donation of \$10,000,000. Additionally, PHEAA provided donated services valued at \$745,432 and gifts of office furnishings and equipment valued at \$35,577. The donated services and gifts of office furnishings and equipment that PHEAA provided to the Foundation were valued at PHEAA's actual cost and reported as contribution revenue and as assets or expenses in the financial statements. All support provided by PHEAA is classified as temporarily restricted gifts since the donations are restricted to 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 \$50,000,000 before June 30, 2009. On July 22, 2005, PHEAA made a cash donation of \$10,000,000 to the Foundation, reducing this amount to \$40,000,000. Additionally, PHEAA 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.

(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 3 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) Functional Allocation of Expenses

The costs of supporting the programs and other activities have been summarized on a functional basis in the consolidated statements of activities. Expenses have been classified based upon the actual direct expenditures and cost allocations based upon estimates of time spent by Foundation personnel.

(g) 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, 2005 and 2004 consist of the following:

	2005	2004
Unrestricted	\$ 59,204	5,859
Temporarily restricted:		
Nursing Education Initiative	427,783	207,415
PHEAA's statutory purposes	37,809,871	33,610,752
Total temporarily restricted	38,237,654	33,818,167
Total net assets	\$ 38,296,858	33,824,026

#### 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, 2005 and 2004 were as follows:

	2005	2004
Short-term:		
Commonwealth of Pennsylvania State Treasury short-term investment pool	\$ -	212,729
Savings account	188,789	324,285
	<u>188,789</u>	<u>537,014</u>
Long-term:		
Equity mutual funds	8,148,405	197,044
Equity investments	16,748,873	1,505,063
Fixed income funds	12,139,858	796,797
Cash and money market securities	2,362,470	32,067,277
	<u>39,399,606</u>	<u>34,566,181</u>
	<u>\$ 39,588,395</u>	<u>35,103,195</u>

Investment income (losses) for the years ended May 31, 2005 and 2004 were as follows:

	2005	2004
Short-term:		
Interest	\$ 2,162	2,358,189
Long-term:		
Interest and dividends	757,959	32,100
Net unrealized and realized gains (losses)	1,187,250	(21,968)
	<u>1,945,209</u>	<u>10,132</u>
	<u>\$ 1,947,371</u>	<u>2,368,321</u>

**7. Pledges Receivable**

Pledges receivable at May 31, 2005 and 2004 consist of the following:

	2005	2004
Due within one year	\$ 10,000	-
Due within the year ending May 31, 2007	10,000	-
	<u>20,000</u>	<u>-</u>
Less unamortized discount	(291)	-
	<u>\$ 19,709</u>	<u>-</u>

Contributions of unconditional promises to give (pledges) are recognized as revenue when signed pledges are made. All pledges are considered fully collectible; accordingly, no allowance for uncollectible pledges has been recorded. Pledges due beyond one year have been recorded at the present value of their estimated future cash flows using a discount rate of 3 percent.



### 8. Office Furnishings and Equipment

Office furnishings and equipment at May 31, 2005 and 2004 were as follows:

	2005	2004
Office furnishings and equipment	\$ 118,584	113,472
Vehicle	41,628	41,628
Software	413	-
	<u>160,625</u>	<u>155,100</u>
Less accumulated depreciation	(48,198)	(25,275)
	<u>\$ 112,427</u>	<u>129,825</u>

### 9. Agency Transactions

The Foundation receives donations for which the donor is involved in directing the donation to specified organizations that qualified for Foundation programs. 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.

Amounts payable to specific organizations as designated by donors at May 31, 2005 and 2004 were as follows:

	2005	2004
Balance at beginning of period	\$ 1,413,333	-
Donations received	1,155,000	1,413,333
Less donations transferred to specific organizations	(1,465,833)	-
Balance at end of period	<u>\$ 1,102,500</u>	<u>1,413,333</u>

For the agency transactions, the Foundation has committed to providing matching funds to donations within the Nursing Assistance Program based on a percentage of the amount donated to the Nursing Education Grant Program. For the years ended May 31, 2005 and 2004, the Foundation provided matching funds of \$207,917 and \$0, respectively. These amounts are recognized as expenses within the consolidated statements of financial position when the recipients have been identified.

### 10. Defined Contribution Pension Plan

The Foundation has a defined contribution pension plan. The Foundation's contribution is based on a percentage of salary. The pension plan expense for the years ended May 31, 2005 and 2004 were \$14,500 and \$0, respectively.

### 11. Subsequent Event

On July 22, 2005, PHEAA made a cash donation of \$10,000,000 to the Foundation.



## **12. 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 2005-06 program year, the Foundation has received approximately 120 applications and grant proposals that, if approved by the Board of Directors, will result in grants of approximately \$10,923,166. Included within this amount are agency transactions for \$1,435,833. 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, 2006. In addition, the Foundation has committed up to \$2,250,000 in matching funds for the 2005-06 academic year to encourage other organizations and individuals to provide scholarship funds for nursing students and \$1,000,000 for a career awareness campaign.

In June 2005, the board of directors adopted a resolution authorizing an amount up to \$40,000,000 over a four year period ending June 1, 2009 for the Nursing Education Capacity Initiatives. These amounts will be used to address the Commonwealth's nursing shortage by providing financial aid with a specific view towards increasing nursing school capacity and the number of students who are able to seek a graduate degree program in nursing.