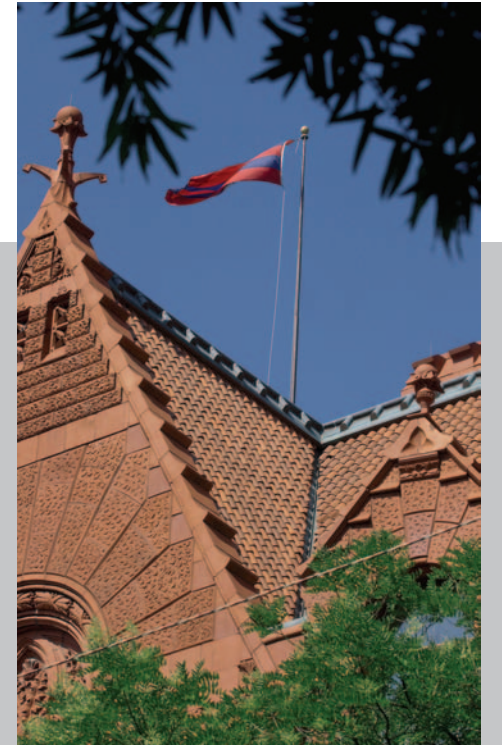


# financial report



2002-2003

# at-a-glance

PENN AT-A-GLANCE

**Student Enrollment (full-time equivalent)\*:**

Undergraduate students 10,682  
Graduate & professional students 9,765

**Undergraduate Admission Statistics:**

Applications 18,831  
Percent accepted 20.4%  
Percent matriculated 63.1%

**Faculty:**

Standing Faculty 2,363  
Associated Faculty 2,035  
Total 4,398

**Financial Summary:**

Total Operating Revenue \$3,584,349  
Total Operating Expenditures \$3,562,752

**Principal Sources of Revenue:**

Tuition and fees (net) \$486,065  
Sponsored programs \$646,674  
Hospitals and physician practices \$1,873,339  
Contributions \$246,931  
Investment income\*\* \$175,322

**Principal Purposes of Expenditures:**

Instruction \$684,866  
Research \$526,130  
Hospitals and physician practices \$1,842,048

**Endowment:**

Market Value \$3,547,473  
One-year endowment performance\*\* 4.7%

**Net Assets:**

Unrestricted \$2,684,286  
Temporarily restricted \$1,164,424  
Permanently restricted \$1,479,768

Dollars in thousands

\* Note that full-time equivalent enrollment is calculated based on the number of full-time students plus 1/3 of the headcount for part-time students. Student, admission and faculty statistics are for academic year 2003 (class beginning September 2003), while financial statistics are for fiscal year 2003 (year ending June 30, 2003)

\*\* Includes gains and losses on investments

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# leadership

## LEADERSHIP AT PENN

The quotes below are attributed to Benjamin Franklin, founder of the University of Pennsylvania, from over two hundred years ago. Founding Penn is but one of Franklin's many accomplishments, which also include his achievements as a statesman and founding father of our country, a successful business person, a scientist and inventor, a philosopher, a musician, and an economist.

Franklin's quotes continue to embody the spirit of Penn today. Penn's enormous success on many fronts can be attributed to the vision, energy, dedication and leadership skills of our many constituents. Penn continues to be a remarkable institution largely due to the collection of people that support the institution in various ways. Throughout this year's publication, you will have the opportunity to learn about the "People of Penn." The profiles highlight examples of excellence exhibited by alumni, faculty, staff and students and how the spirit and creativity of our founder continue to flourish at Penn. While annual reports typically focus on the financial activity of an organization, this year's report profiles the people behind the numbers. These human assets are not reported on the balance sheet, yet contribute vitally to Penn's financial success.

“Never leave that till tomorrow  
which you can do today.”

“Well done is better  
than well said.”

### models of excellence



Wendy L. Hatchett, Kym Marryott, and Donna Oakley, certified veterinary technicians at the School of Veterinary Medicine, as well as members of the Penn Animal Blood Bank Nursing Team, were among the winners of Penn's Models of Excellence awards. Their revolutionary work led to the design and implementation of a volunteer canine blood-donor program.

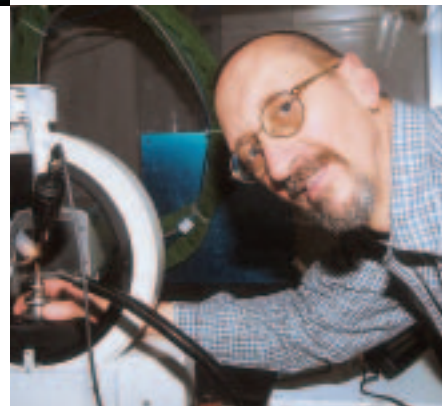


### models of excellence

Patrick J. Carroll, Ph.D., Director, X-Ray Facility, Department of Chemistry, was named a Models of Excellence award winner for his advancements in x-rays. Dr. Carroll dramatically enhanced research in the Department of Chemistry through his development of hardware and software applications that revolutionized x-ray crystal structure analysis and reporting.

### ben franklin

Eager to create a college to educate future generations of Philadelphians, Benjamin Franklin presented his vision of the "Publick Academy of Philadelphia" in the fall of 1749. Circulating his ideas in a pamphlet titled "Proposals for the Education of Youth in Pennsylvania," he advocated an innovative concept of higher education, one which simultaneously taught the ornamental knowledge of the arts and the practical skills necessary for lives of business and public service. With his characteristic zeal and determination, Benjamin Franklin created America's first university.



# message

MESSAGE FROM THE SENIOR VICE PRESIDENT  
FOR FINANCE AND TREASURER

Despite the backdrop of global economic and political uncertainty, fiscal year 2003 was strong for Penn overall. For the third straight year, we achieved positive financial performance in both the Academic and Health System components of the University. For the fiscal year, consolidated University net assets increased by \$172.2 million to a total of \$5.3 billion at June 30, 2003.

The Academic Component again experienced double-digit growth in its sponsored program revenue (primarily reflecting NIH grant activity in the School of Medicine) as well as a significant increase in tuition and fee revenue. Operating gifts grew to a record level this year. Student demand indicators continued to trend positively, reflected by a continued improvement in the acceptance and matriculation rates to Penn. Student quality measures also advanced, demonstrated in part by the record level mean SAT score for incoming freshmen. Penn continues to rank among the most select colleges and universities. The September 2003 *U.S. News & World Report* ranked Penn in fifth place among the nation's best universities.

The University of Pennsylvania Health System's (UPHS's) core business remains strong as positive operating margins were reported for the third consecutive year, driven by increased inpatient and outpatient activity and revenue growth. Performance was dampened slightly by continuing restrictions in Medicare payments and increased pension and malpractice insurance expenses. The Health System's flagship hospital, the Hospital of the University of Pennsylvania (HUP), which opened its doors in 1874 as the nation's first hospital built for teaching purposes, has been recognized annually by *U.S. News & World Report's* Honor Roll since 1997. Most recently, it was ranked 13th out of some 6,000 hospitals across the country, and fourteen of seventeen medical specialties were recognized for excellence.

Penn's endowment performed well in a difficult market environment, earning a 4.7% return (approximately the same as its spending rule) in fiscal year 2003. This above benchmark return is the result of diversification of the endowment portfolio to alternative asset classes, to enhance the endowment's risk/return tradeoff. Fiscal year 2003 reflects the third consecutive year that Penn outperformed its peer group and market benchmarks.

The University continued to make significant capital expenditures during fiscal year 2003 in support of its strategic initiatives. Many state-of-the-art academic and student life facilities were completed and placed into service during the year. New, multi-year research facilities for Life Sciences, Medicine and Veterinary Research were initiated during the year. Additionally, the multi-year renovation of Penn's three undergraduate high rise dormitories began in fiscal year 2003, while the renovation of our historic quadrangle dormitories was completed.

## penn people

Among other events, Alumni Weekend brings together past, current and future members of the Penn family.



## ▼ floyd johnson, public safety

Patrol officer Floyd Johnson, Public Safety's very own Gregory Hines with a badge, has some moves to show you. Johnson performs most weekdays during evening rush hour, at the busy intersection of 36th and Walnut streets. There he is, twirling, whirling, dipping, pointing, waving, and blowing his whistle, all to keep traffic flowing and let pedestrians cross safely and quickly. Johnson not only enjoys his job, but also performs a valuable service.



## ▲ nithya chandra and denise davis-moore

As teacher education students at the Graduate School of Education (GSE), Nithya Chandra (left) and Denise Davis-Moore (right) are learning even more about the challenges and rewards of teaching in an urban setting. Both are recipients of the first Puente-Forchic Scholarship initiated by educator/entertainer Bill Cosby (shown here with Catherine Lacey, Director of GSE's Teacher Education Program). This scholarship supports two GSE Teacher Education students committed to urban education, specifically to working in the Philadelphia public schools for years after completing the program.





# performance

FISCAL YEAR 2003  
PERFORMANCE HIGHLIGHTS

During fiscal year 2003, the consolidated University achieved positive financial performance despite the uncertain economic climate. Penn concluded the fiscal year ending June 30, 2003 with total assets of \$8.1 billion and total liabilities of \$2.8 billion. University total operating revenue increased \$245.8 million, or 7.4%, to over \$3.58 billion. Overall, total operating expenses increased \$255.2 million, or 7.7%. The consolidated University achieved a positive increase in net assets from operating activities of \$21.6 million, a decline of \$9.3 million from fiscal year 2002. The decline can be attributed to higher insurance and utility costs throughout the University, and higher Health System operating costs, including employee benefit expenses (e.g. pension costs). Consolidated University net assets from nonoperating activities increased by \$150.6 million due principally to gifts for capital and endowment and positive investment performance. Plant assets increased by \$77.8 million, net of accumulated depreciation of \$187.4 million.

The Academic Component of the University concluded the fiscal year with total assets of \$6.2 billion, total liabilities of \$1.4 billion, and net assets of \$4.8 billion. Total net assets increased \$161.1 million during the course of the fiscal year. The University experienced a \$130.1 million, or 8.1%, increase in total revenue to over \$1.7 billion. Sponsored programs revenue (including indirect cost recoveries) accounted for over 50% of the growth. Total operating expenses increased \$124.8 million (7.8%). Plant assets increased by \$61.2 million, net of accumulated depreciation of \$102.0 million. Long-term debt decreased by \$31.8 million due to the retirement of the interim K-8 school debt and the scheduled retirement of University debt. Cash flow from operating activities increased by \$23.6 million. Capital investment declined \$32.5 million as several large-scale projects were completed.

The Health System recorded an excess of revenue over expenses (including investment income), which totaled \$47.1 million, lower than the prior fiscal year due to the recognition of unfavorable third party adjustments and higher expenses. Operating revenue increased 6.5% largely due to favorable utilization trends and payment rates. Operating expenses were higher than the comparable prior year period by \$127.1 million (7.4%). The Health System continued its efforts to increase strategically targeted programmatic capital investments. Purchases of property and equipment reached \$97.7 million for fiscal year 2003, exceeding the prior year level of \$80.0 million. Operating cash flow of \$174.6 million (before transfers to the School of Medicine) represents a slight increase from the prior year.

## » ugonna onyekwe

Ugonna Onyekwe graduated from Penn with three Ivy League basketball championships, two Ivy League Player of the Year awards, and 1,762 points – the second greatest number of accolades in the program's prestigious history. Onyekwe played his best game of the season when Penn needed him most, matching a career-high 30 points in the Quakers' first-round NCAA Tournament game against Oklahoma State.



## ▼ katy cross

After being named Ivy League Player of the year, Penn star Katy Cross can now add being selected to the second team all-Mid Atlantic region to her extensive list of soccer accomplishments. Cross led the Quakers in scoring for the second year in a row and now proudly holds Penn's record for most goals scored in a season.



## ▲ brian chaput

University of Pennsylvania communications major Brian Chaput is not only a national champion in the javelin, but excels academically as well. Chaput was named Verizon Second-Team Academic All-American, thus becoming the first Penn track and field athlete to earn national Academic All-American honors. Earlier in the season, Chaput was named Academic All-Ivy League and First-Team All-District II Academic All-American, which qualified him for national honors. Chaput, along with his teammate, Sam Burley, are the first Penn track and field athletes to win an NCAA title in 29 years.

# tuition

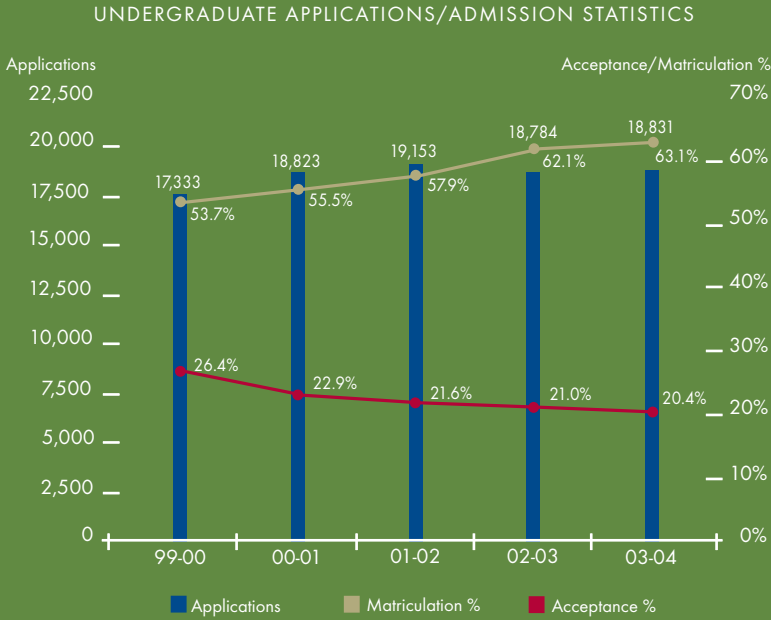
TUITION, FEES AND  
FINANCIAL AID

The Tuition and Fees (net of student aid) component accounts for approximately 13.6% of total operating revenue. Undergraduate, graduate, professional and executive education tuitions are recorded here, along with fee income (e.g., application fee, technology fee, etc.). Four of Penn’s schools - The College (School of Arts and Sciences), School of Engineering and Applied Science, School of Nursing and the Wharton School - offer full-time undergraduate degrees. Over 10,000 undergraduate students attended Penn during the 2002-2003 academic year. Undergraduate tuition and fees for the academic year were set at \$27,988 compared to \$26,630 in 2001-2002, an increase of 5.1%.

Graduate and professional programs are offered by the twelve schools. Tuition and fee rates are set individually by each school. Tuition and fees for full-time programs range from \$25,000 to \$47,000 per year. Approximately 10,000 students took part in these programs during the 2003-2004 academic year.

Penn is one of 33 “need blind” institutions nationally whose undergraduate admissions policy reflects the philosophy that students are accepted on merit, regardless of their ability to pay. In the 2002-2003 academic year, approximately 48% of University undergraduate students received a total of \$82.1 million in grant aid, which consisted of \$63.5 million from the University and \$18.6 million from federal, state, and private sources. This does not include \$4.4 million in undergraduate tuition remission for members of faculty, staff and their dependents, and departmental grants.

Approximately 13% of the non-grant undergraduate financial aid budget is covered by endowment income. The relatively small size of financial aid endowment requires a dependence on the general operating budget to cover much of our aid expenses. Raising endowment for undergraduate financial aid has been and continues to rank among the University’s highest fundraising priorities.



## annemarie fernandes

Annemarie Fernandes, a junior, is one of the three Penn students who was awarded the Goldwater Scholarship which pays tribute to the leadership, courage, and vision of Senator Goldwater. The Goldwater Scholarship was established and endowed in his name to recognize and foster excellence in science and mathematics. Mentored by Dr. Eric Bernhard, Fernandes is involved in Radiation Oncology research.



## richard vidal

Richard Vidal, a first-year student in the Medical School, was awarded the Paul & Daisy Soros Fellowship. The award will pay for two years of graduate school for Vidal, who plans on pursuing both an M.D. and MBA. Vidal demonstrated dedication to health around the world by founding a non-profit organization, International Medical Outreach (IMO), which trains pre-med students to deliver healthcare services in developing countries. Vidal was one of only 30 applicants to receive the generous fellowship.

## adam zimbler

Adam Zimbler, a senior in the Huntsman Program in International Studies and Business and a Joseph Wharton Scholar, received a Marshall Scholarship, one of only 40 awarded annually. The Marshall Scholarship will allow Zimbler to pursue his interest in extra-legal constitutions and covenants, such as those employed by pirates, from the scholarly towers of Oxford University. Zimbler credits Penn's Huntsman Program for giving him a chance to pursue various intellectual interests, which range from business ethics to political theory. Zimbler is the fifth Penn student to win a Marshall Scholarship since the program began in 1953.





# appropriations

COMMONWEALTH APPROPRIATIONS

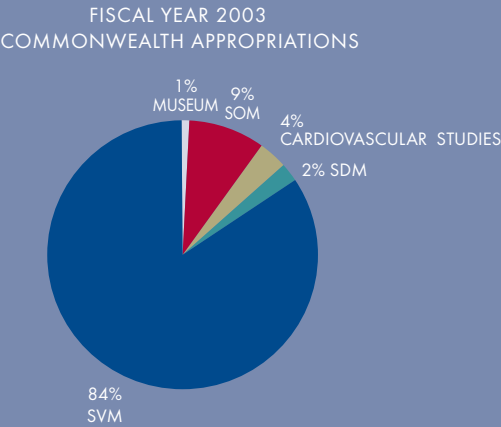
Each year the University submits a request for Commonwealth of Pennsylvania appropriations from the Department of Education. In fiscal year 2003, the University appropriation from the Commonwealth totaled \$44.3 million.

The primary beneficiary of the Commonwealth Appropriation is the School of Veterinary Medicine (SVM). Serving as the sole site of veterinary medicine professional education in the Commonwealth, SVM provides education in veterinary medicine and animal health services. The School advances the agricultural economy of the Commonwealth through its program in production medicine, the strongest such program in the nation. SVM operates two animal hospitals, both with international reputations for excellence in clinical care: The Matthew J. Ryan Veterinary Hospital in Philadelphia for companion animals and the Widener Hospital for Large Animals at the New Bolton Center in Chester County. The School is also noted internationally for its excellence in basic research with special emphasis on stem and germ cell biology, infectious disease research and genetics.

The School of Medicine’s (SOM’s) fiscal year 2003 appropriation was used to support medical student education programs. The funds were allocated to SOM academic programs offices and departments, including the continued development and implementation of a new medical student curriculum for the twenty-first century, Curriculum 2000®. Financial support from the Commonwealth has also been used to continue and initiate research that has the potential to dramatically improve the methods and outcomes of treatment of cardiovascular disease.

The School of Dental Medicine (SDM), a major dental care provider for the residents of the Commonwealth, serves as a primary site for emergency dental care in Southeastern Pennsylvania. Penn promotes access to dental care for low-income individuals in Philadelphia and neighboring counties. Penn also serves the community through its clinics and outreach programs. The PennSmiles program, which addresses the oral health needs of children, began operation of a mobile dental van in February 2003.

The University of Pennsylvania Museum of Archaeology and Anthropology, which was recently named by Discover Magazine as one of the world’s ten great science museums, provides outreach and public programming. Residents of 57 counties in the state benefit from the Commonwealth Lecture program, while students benefit from the “Museum on the Go” program, which delivers guides and artifacts to elementary and middle schools.



## ralph brinster

Dr. Ralph L. Brinster, Richard King Mellon Professor of Reproductive Physiology at the School of Veterinary Medicine, has been selected as a recipient of the 2002-2003 Wolf Prize in Medicine. The Wolf Prize Jury cited him "for the development of procedures to manipulate mouse ova and embryos, which has enabled transgenesis and its applications in mice."



## hans scholer

Dr. Hans Scholer, the Marion Dilley and David George Jones Chair in Reproduction Medicine and associate professor of reproductive physiology at Penn’s School of Veterinary Medicine, along with a team of researchers at Penn, has identified a receptor that plays a key role in restricting embryonic stem cells’ pluripotency. Pluripotency is the ability for stem cells to develop into many different types of adult cells. By repressing this mechanism, it may be possible to find new ways of creating embryonic stem cells without using embryos.



## new bolton center

Agriculture is the foundation of Pennsylvania’s economy. The School of Veterinary Medicine and its emphasis on food animal health, productivity, and economics provides continuing benefits to the Commonwealth. The School’s mission embodies the traditional and innovative role of providing health care and protection of the Commonwealth’s food and fiber-producing animals, as well as its wildlife, companion, sporting, laboratory, zoo, and aquatic animals.





# sponsored

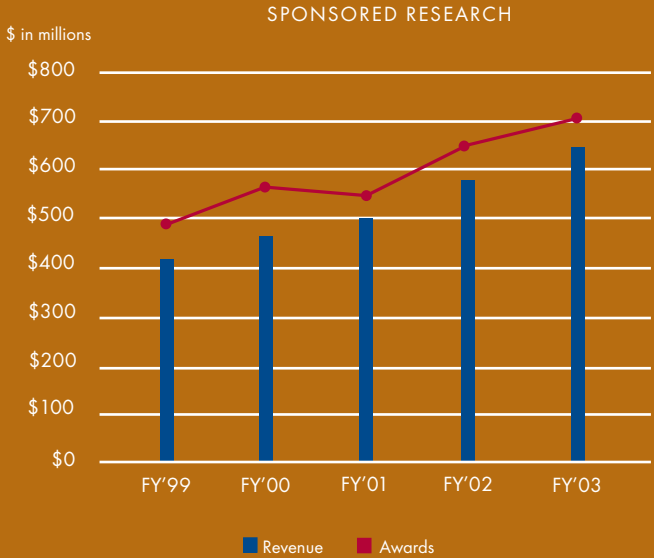
SPONSORED PROGRAMS

Sponsored program activity provides over 18.0% of the University's total revenue. Sponsored program support includes the direct and indirect costs of sponsored research activity. In fiscal year 2003, sponsored program revenue totaled \$646.7 million, an increase of over \$66.9 million (11.5%) compared to fiscal year 2002. The indirect cost component grew by \$17.8 million to \$161.6 million, an increase of 12.4%. Total awards received reached over \$704 million, an 8.2% increase from last year's record of \$651 million.

A total of \$451.2 million in awards were received from the Department of Health and Human Services, including the National Institutes of Health (NIH), Penn's largest sponsor, for research, training, fellowships and other programs. Penn ranked second in NIH funding for the latest available federal fiscal year (2002).

Over the past ten years, Penn has seen significant growth in sponsored program funding. In fiscal year 1993, the University received \$274 million in awards, compared to over \$704 million received in fiscal year 2003. This \$430 million increase over the decade represents an annualized growth rate of nearly 10%. Penn has benefited significantly from the substantial increase in the budget of the NIH, its primary federal sponsor, which doubled in the last five years. However, the NIH budget is programmed for only modest increases in the future, which the University will continue to monitor. Congress has been working with the National Science Foundation (NSF), historically the second largest federal sponsor of research at Penn, to increase its budget substantially over the next several years. We anticipate that increases in NSF budgets will benefit the University.

There are many examples of Penn research with broad applicability, including the Linguistic Data Consortium (LDC), the EARS (Effective, Affordable, Reusable Speech to-Text) program and the TIDES (Translingual Information Detection Extraction and Summarization) program. The LDC, which has been hosted by the University of Pennsylvania since 1992, brings together educators, researchers and technology developers from around the world. Researchers use annotated corpora of speech, text and gesture to perform primary linguistic description and documentation, to develop speech and language technologies and to teach foreign languages. The EARS program is developing high quality speech-to-text systems capable of transcribing broadcast and telephone speech as well as the proceedings of meetings and conferences. The TIDES program has created component technologies that search across multiple languages for documents relevant to a query, that extract key information from those documents, that build multiple document summaries and that translate the documents and their summaries into English.



## stephen kimmel, m.d. »

Dr. Kimmel is directing a collaboration to reduce disparities in hypertension seen in African-American and low-income adults compared to the general population. With nearly \$4.8 million of support from the Commonwealth of Pennsylvania, Dr. Kimmel, of Clinical Epidemiology and Biostatistics and the Department of Medicine, has organized a collaboration with Penn, small colleges, and non-profit community health institutions throughout Pennsylvania to reduce economic and non-economic barriers to high blood pressure medication adherence.



## ▼ drs. john and loretta jemmott

Penn is proud of its collaboration with the nation's leading HIV prevention husband-and-wife research team Dr. John B. Jemmott III, the Kenneth B. Clark Professor of Communication and Dr. Loretta Sweet Jemmott, the van Ameringen Professor in Psychiatric Mental Health Nursing. The Jemmotts have received over \$80 million in funding from the National Institutes of Health. The Centers for Disease Control and Prevention (CDC) selected three of their HIV prevention curricula for dissemination nationally. They have recently extended their HIV prevention research to South Africa.

## ▲ istar

After September 11, Penn considered the calls for action and analysis in the context of the traditional values of institutes of higher learning and formed the Institute for Strategic Threat Analysis and Response-ISTAR, led by director Harvey Rubin, MD, PhD. Broadly-based, multidisciplinary teams, as well as individual faculty members and students, are already involved in the generation and evaluation of hypotheses, theories, technologies, and policies that relate to strategic threats and responses to these threats. Specific areas of study include biological agents and infectious diseases, public health, bio-defense infrastructure, disaster tolerance and recovery, strategic defense analysis, and risk assessment issues.



# contributions

DEVELOPMENT AND  
ALUMNI RELATIONS

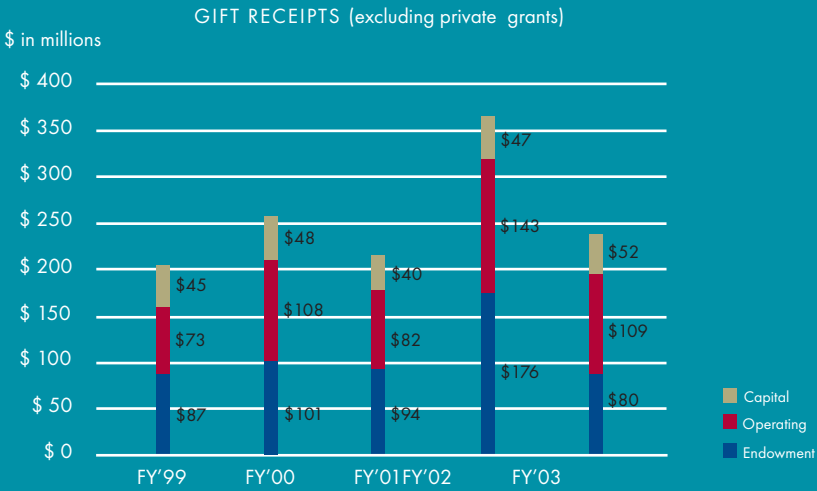
Fiscal year 2003 contributions (exclusive of private grants) totaled \$246.9 million. Operating contributions grew \$7.7 million, or 8.3%, over fiscal year 2002 levels. Nonoperating contributions – which include gifts for endowment and capital – declined by \$78.3 million due to the impact of the \$100 million irrevocable trust created by the Annenberg Foundation in support of the Annenberg School in fiscal year 2002. Adjusting for this significant gift results in a \$21.7 million (17.4%) increase in fiscal year 2003 nonoperating contributions. Cash receipts (exclusive of private grants) for the year totaled \$241.6 million.

Fiscal year 2003 was the final year of the Wharton School’s seven-year *Campaign for Sustained Excellence*, which concluded with a grand total of \$445.8 million, exceeding its stretch goal of \$425 million by 5%. Raising more than \$15 million in its final week, the campaign’s momentum was evident in the spirited participation of the 2003 MBA class, which achieved 98% participation in its support for unrestricted giving at Wharton.

Participation was also a special emphasis of The Penn Fund, the University’s annual giving program for undergraduate alumni. *PROJECT 5000*, The Penn Fund’s initiative to attract 5,000 new donors, met its goal and contributed to the overall success of the University’s annual giving programs, which raised a record \$34.3 million.

Fundraising efforts with current Penn parents also yielded record-setting results – a 23% increase in participation, \$17 million in designated major gifts, and \$1.3 million in unrestricted annual gifts to The Parents Fund.

Alumni participation in the life of the University surged during fiscal year 2003 in response to new and expanded programming and other outreach. Attendance at Alumni Weekend was up nearly 40% among undergraduate alumni, who were able to take advantage of a 67% increase in educational programming hours during the weekend. The average increase in unrestricted gifts to The Penn Fund by reunion classes was 94%, and increases in participation averaged 37%. Reunion giving this year had a particular impact on endowed undergraduate scholarships; more than 80 scholarships were created with gifts from reunion classes.



## alumni weekend ▶▶

Penn’s distinction as one of the world’s great universities is reflected each year in Alumni Weekend, which celebrates the lifelong connection between Penn Alumni and their alma mater through a wide variety of activities and festivities that engage both head and heart.



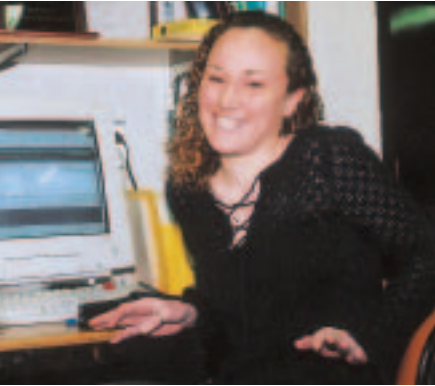
## ▼ 125th anniversary scholarship

A model scholar-athlete, Claire Duncan, C’05, is the first recipient of the 125th Anniversary of Penn Women Scholarship, created in 2001 as an enduring legacy of the Celebration of 125 Years of Women at Penn. The 125th Scholarship has enabled Claire to pursue a double major in international relations and environmental studies and a minor in Spanish, all in preparation for a career in international humanitarian activities, environmental law, or political advising. Outside the classroom, Claire went from being a walk-on with the cross-country team to its “most valuable freshman.”



## ▲ “250 in 5” scholarship challenge

Inspired at their 10th reunion by the spirit of the Penn Relays, David France, C’89, (left) and Lolita Jackson, ENG’89, (right) launched the “250 in 5” campaign – an initiative to raise \$250,000 in five years for Penn’s W.E.B. DuBois Scholarship program. Sprinting ever since, the team quickly surpassed its initial goal and only four years later their campaign stands at more than \$860,000. Praising “all they have accomplished,” University Trustee and Penn Alumni President Paul Williams, W’67, (center) pledged \$25,000 during fiscal year 2003 for a special “relay challenge” designed to encourage the group to keep fundraising and making Penn accessible for promising students.





# endowments

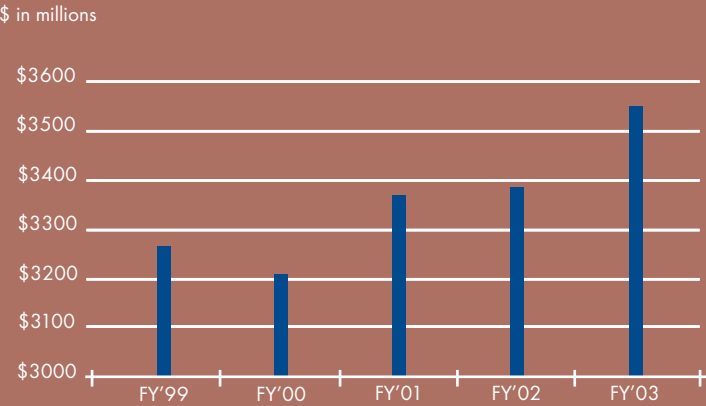
## ENDOWMENTS AND INVESTMENTS

Penn’s endowment ended the 2003 fiscal year with \$3.5 billion in investment assets. The Associated Investments Fund (“A.I.F.”), in which about 81% of the endowment is invested, ended the fiscal year with a 4.7% gain, which was 1.1% ahead of its composite benchmark, and represented its third positive fiscal year in a row. Penn’s cumulative performance over the last three fiscal years is a gain of 11%. Over the same period, the composite benchmark’s cumulative performance was a loss of 10.4% and a hypothetical portfolio invested 70% in the Wilshire 5000 stock index and 30% in the Lehman Government/Corporate bond index would have produced a cumulative loss of 11%. Penn also performed well compared to its peers over the past three fiscal years. The median average annual return for 56 non-taxable institutions with over \$1 billion in assets was a 1.4% loss for fiscal years 2001 through 2003 as reported by Cambridge Associates. In comparison, Penn gained 3.5% per annum on average over the same period.

Fiscal 2003 was an extremely volatile year for worldwide markets. In the first fiscal quarter, the Wilshire 5000 stock index lost 16.8%, which was the worst quarter for the stock market since 1987. The quarter was plagued by issues of corporate governance which seemed to wreak havoc on the markets. Conversely, in the fourth fiscal quarter stock markets produced solid gains; in April and May alone the A.I.F. gained almost 10%, which pushed the return into positive territory for the year.

Although the A.I.F.’s performance was helped by its allocation to public equity markets, those markets still only produced modest returns for the fiscal year. Despite impressive gains in the last fiscal quarter, the Wilshire 5000 ended the fiscal year with only a 1.3% return. Importantly, it was other asset classes that produced the bulk of the A.I.F.’s return for the year. The endowment’s investment grade bonds, high yield bonds, and absolute return portfolio, which represent about 40% of the A.I.F., together gained almost 12% for the year.

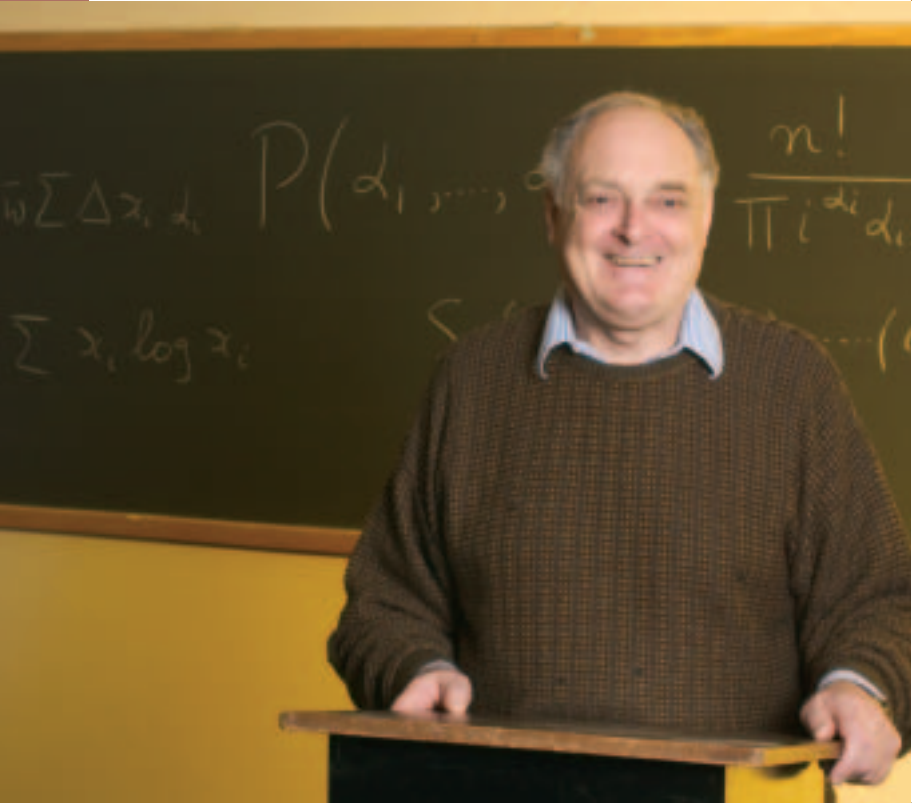
ENDOWMENT GROWTH\*



\* Valuations as of June 30

### shazia khan »

Shazia Khan, C'05, a recipient of the Solomon Rothschild Family Endowed Scholarship Fund, is pursuing a dual major in biology and cognitive science with an emphasis on computational biology. She writes that the Rothschild Scholarship has been “invaluable” in shaping her future. “Whatever success I enjoy will be thanks to your efforts to make the Penn experience more accessible to students like myself.”



### ▼ amber birtcher

Amber Birtcher, C'07, a recipient of the Peter and Barbara Noris Family Endowed Scholarship, was one of a select group of students chosen to be a Leadership Scholar based on her outstanding academic performance and leadership. A student in the College of Arts and Sciences, Amber plans to study psychology and pursue a career as a psychologist.



### ▲ warren ewens

In 2003, Warren Ewens was awarded the Christopher H. Browne Distinguished Professorship in Biology. The Browne Professorship is considered one of the highest honors that the School of Arts and Sciences bestows on its faculty. Ewens is a leading scholar of population genetics theory and an elected member of the prestigious Royal Society of London. He was also the recipient of the University’s highest teaching honor, the Lindback Award. Ewens has introduced growing subfields of mathematical and computation biology into Penn’s curriculum in the undergraduate and graduate programs.

# health system

UNIVERSITY OF PENNSYLVANIA  
HEALTH SYSTEM

In fiscal year 2003, the University of Pennsylvania Health System (UPHS), comprising the health services component of PENN Medicine, continued its positive financial trend. For the third consecutive fiscal year, UPHS generated a surplus, with an operating margin of \$42.3 million and a total margin (which includes other unrestricted income) of \$47.1 million. In addition, patient activity showed a net increase over fiscal year 2002 of 3.5% in admissions and 3.8% in outpatient activity involving the Penn hospitals and the faculty practices (Clinical Practices of the University of Pennsylvania - CPUP). Days in accounts receivable continued to decrease from fiscal year 2002.

For the seventh consecutive year, the Hospital of the University of Pennsylvania (HUP) was named to the Honor Roll of American Hospitals by *U.S. News & World Report*. One of only 17 hospitals in the country so named, HUP was ranked 13th overall and was commended for excellence in 14 medical specialties.

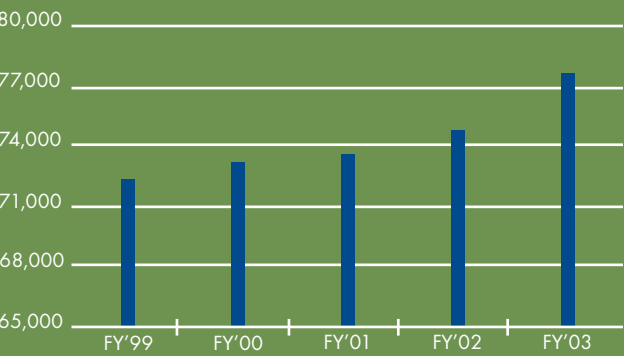
The extensive strategic planning that had been taking place over several months was consolidated in the “Plan for PENN Medicine.” (PENN Medicine is an umbrella governance structure comprised of UPHS and the School of Medicine.) Part of the Plan focused on clinical delivery - in particular the goals of building superb clinical programs that distinguish PENN Medicine in the marketplace - and establishing undisputed leadership in patient-care quality. In the latter case, Penn has taken important steps with the Clinical Excellence and Quality Initiative program and P.O.R.T.S., a system-wide electronic reporting system.

The Plan for PENN Medicine recognizes that the local health-care market is one of the most competitive in the nation, and hospitals in Pennsylvania face particularly intense financial pressures in rising costs of labor, supply, malpractice coverage, and uncompensated care. Yet one of PENN Medicine’s advantages is a strong reputation for clinical excellence. The strategic plan aims to strengthen the position of HUP and the West Philadelphia campus as a referral center for the region and strengthen our signature service lines, which are cancer, cardiovascular care, neurosciences, surgery, women’s health, and transplantation. A related priority is to fully leverage Penn’s world-renowned research capabilities to support these service lines.

One of the paths outlined in the Plan for PENN Medicine for supporting its three interrelated missions is to improve the yield from technology transfer and partnerships. To increase its appeal as a partner of first choice for pharmaceutical, biotechnology, and medical-device companies, PENN Medicine has recently established the Office of Corporate Alliances. Earlier this year came an example of this kind of alliance when the School of Medicine received an unrestricted gift of \$10 million from one of the world’s leading pharmaceutical companies, GlaxoSmithKline.

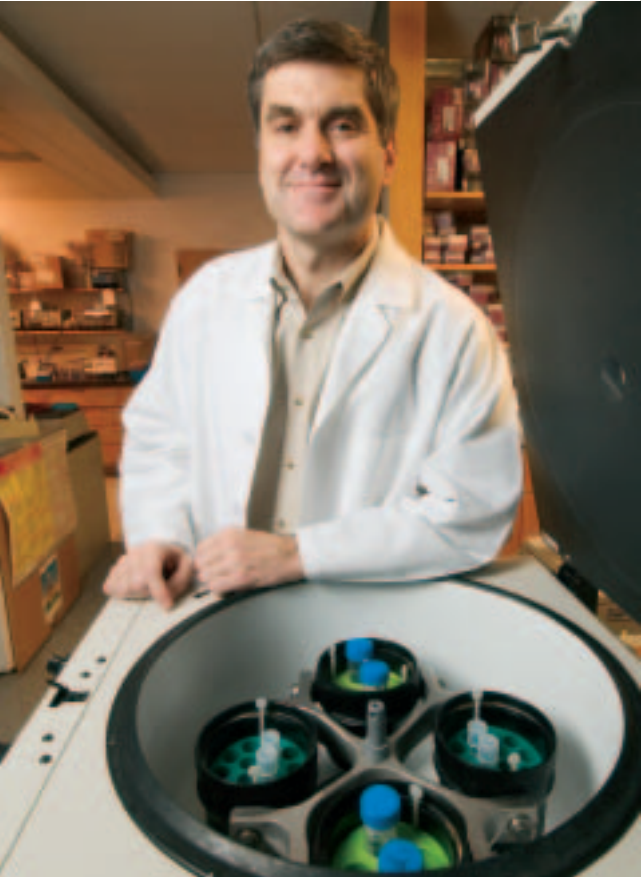
The introduction of robotics in the Department of Surgery was among the most exciting clinical advances at UPHS in fiscal year 2003. Surgeons are using the da Vinci Surgical System, a state-of-the-art robotic system that takes minimally invasive surgery to new heights by allowing more precision and reduced recovery times. At first, the system was used in cardiac surgery to perform coronary artery bypass grafts. More recently, the robotic system has been used in kidney transplants.

ADULT INPATIENT ADMISSIONS



## ▼ mitchell a. lazar, m.d., ph.d. ►►

Faculty member Mitchell A. Lazar, M.D., Ph.D., received a \$500,000 grant from the Bristol-Myers Squibb Unrestricted Biomedical Research Program to support his work in the field of metabolic and neuroscience research. Lazar excels not only at studying the basic molecular underpinnings of a disease, but also at translating his findings into medical practice.



## ▼ virginia m.-y. lee, ph.d.

Virginia M.-Y. Lee, Ph.D., also received a \$500,000 grant from the Bristol-Myers Squibb Unrestricted Biomedical Research Program to support her work in the fields of metabolic and neuroscience research. Lee has also demonstrated excellence in exploring the basic molecular underpinnings of a disease, and applying her findings to pertinent medical practice.

## ▲ craig b. thompson, m.d.

One of the year’s most promising findings was presented by researchers from Penn’s Abramson Cancer Center. They found that a new kind of drug, a Raf kinase inhibitor, is well tolerated and may prove effective in treating patients with metastatic melanoma, the most severe form of skin cancer. The finding is especially welcome, because standard chemotherapy has limited effectiveness against metastatic melanoma.





# income

OTHER SOURCES  
OF INCOME

Reflecting the entrepreneurial spirit of the Penn community, Schools and Resource Centers generate revenues from a variety of sources which are closely tied to the academic mission of the University. Other Income, Sales and Services and Independent Operations account for 7.5% of total consolidated University revenue.

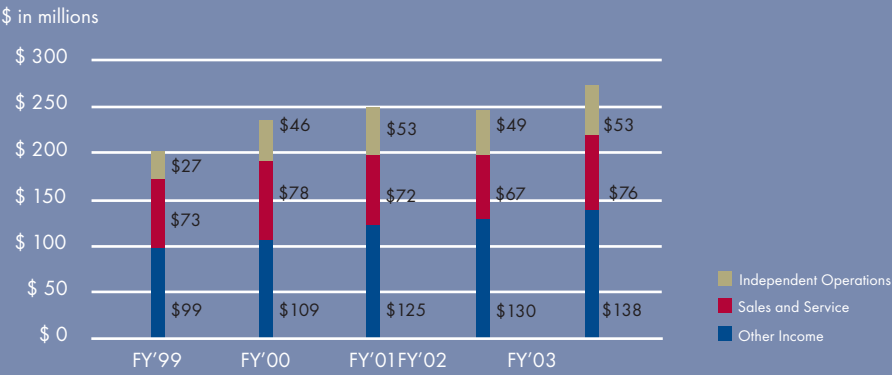
Other Income increased \$8.4 million, or 6.5%, to \$138.4 million. Other income includes revenue from patient care, animal care, technology transfer licensing activity and executive education room and board. Animal care revenues include fees paid by individuals who bring pets and animals to the Ryan Veterinary Hospital or the Widener Hospital for Large Animals. Patient care revenues include income associated with the Living Independently for Elders (LIFE) Nursing program. LIFE is an adult day health center where teams of providers manage the complex medical, functional and psycho-social problems faced by elderly clients. Technology Transfer revenues are related to the commercialization of intellectual property resulting from the University's research. Executive education programs provide executive coursework through on-campus courses, distance learning and videos.

Sales and Service income totaled \$76.4 million in fiscal year 2003, an increase of \$9.3 million, or 13.8%, compared to the prior year. Sales and Service income includes dormitory rent, dining service income, parking income, and income generated by the Penn Computer Connection (the campus computer retail outlet). Dormitory rent is received from over 6,500 students that live in Penn's college housing each semester and includes various room and board charges. The average room and board charges for an undergraduate student total over \$8,000 per semester. Dining services is managed by ARAMARK Corporation, a Philadelphia based company specializing in food and facility management. Parking income is driven primarily by the sale of permits to Penn faculty, staff and students. Of the 6,200 available spaces, approximately 85% are sold as permit parking.

Independent Operations revenue increased \$3.6 million, or 7.4%, to \$52.5 million. Independent Operations includes revenues from University City Associates, Inn at Penn and Penn Club. University City Associates manages real estate owned and rented by the University of Pennsylvania. The Inn at

Penn is a full service, AAA-Four diamond 238 room hotel located in the heart of Penn's Campus and managed by Hilton Hotels Corporation. The Penn Club of New York, located in midtown Manhattan, is a club for those affiliated with the University of Pennsylvania. The Penn Club boasts 13 floors filled with dining rooms, a health club, meeting space, banquet facilities, 39 guest rooms, a library, and a business center.

OTHER SOURCES OF INCOME



## schattner dental clinic »

Penn's Schattner Dental Clinic is a leading provider of dental care for the Philadelphia area, serving over 16,000 individuals each year in its main teaching clinics. The Schattner Dental Clinic provides patients with affordable access to quality care, delivered by students working under close supervision of faculty.



## ▼ life

Living Independently For Elders (LIFE) is a program of all-inclusive care for the elderly. LIFE is a service of the School of Nursing's Penn Nursing Network. LIFE aims to foster independence and health, preserve dignity, and help elders continue to reside in the community for as long as possible.

## ▲ student residences - hamilton house

A former Graduate Advisor for both Hill and Hamilton College Houses, Tabitha Dell'Angelo was appointed House Dean of Hamilton in Fall 2002. She is currently completing a doctorate in Human Development at the University of Pennsylvania and earned an MS in Education from Penn in 1999. Dell'Angelo has conducted research and written publications that focus on positive youth development; grades among urban school districts; teachers' perceptions of achievement; race, community, inequality, and achievement; and identity-focused intervention for urban youth.



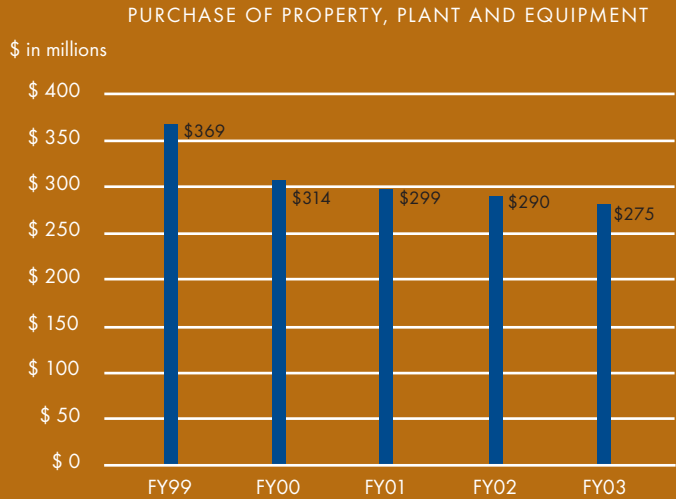
# investment

CAPITAL INVESTMENT

Penn’s campus continued to grow in quality and vibrancy in fiscal year 2003. Many large, multi-year capital projects were placed in service this year, including several significant academic facilities for students and faculty: Huntsman Hall (Wharton School), Levine Hall (School of Engineering and Applied Science), and the Schattner Building (School of Dental Medicine). Noteworthy student housing initiatives continued this year as the three-year \$75 million Quadrangle renovation project was completed and a four-year renovation of the three undergraduate high rise dormitories, currently estimated to aggregate approximately \$80 million, began. The renovation of the undergraduate high rise dorms, Hamilton House, Harrison House and Harnwell House, will occur over four consecutive summers to avoid student disruption during the academic year. The state-of-the-art Pottruck Fitness Center, improved Rhodes soccer field, and the new Carriage House Student Center, all of which opened in 2003, helped enhance the quality of life for Penn’s students. At the same time, the opening of the Penn-assisted K-8 school and Bridge Cinema de lux this year contributed positively to the further evolution of Penn’s West Philadelphia neighborhood.

Supporting Penn’s significant research mission, several large, research-oriented capital projects began or continued in fiscal year 2003. These included Skirkanich Hall (School of Engineering and Applied Science), the School of Veterinary Medicine Teaching and Research building, and the Life Sciences Building (School of Arts and Sciences). These multi-year projects, which are in their early stages and whose costs aggregate over \$100 million, will be funded by grants, gifts, and internal resources. Also supporting Penn’s research infrastructure is the first phase of the PennERA (Electronic Research Administration) system, which is expected to be completed in fiscal year 2005.

The opening in fiscal year 2003 of a 1,954 space parking garage - in conjunction with neighboring Children’s Hospital of Philadelphia on the former Civic Center site - will support the Health System and its major initiatives. In addition, preliminary studies regarding an ambulatory care facility on the Civic Center site were undertaken this year as a result of a Health Resources and Services Administration (HRSA) planning grant. More detailed plans and decisions on scope will follow in future fiscal years.



Other capital initiatives that were undertaken throughout the Health System during fiscal year 2003 included the expansion of Pennsylvania Hospital's Widener Building to accommodate 45 additional intensive care beds (expected to be completed in fiscal year 2004), enhanced cardiac catheterization labs at the Hospital of the University of Pennsylvania, construction of a new ambulatory surgical facility approximately ten miles from Phoenixville Hospital known as “Penn Surgery at Limerick”, and the renovation of Presbyterian Medical Center's emergency room. The Health System's capital spending, including equipment acquisitions, totaled \$97.7 million in fiscal year 2003. This level of capital investment represented the highest amount since fiscal 1999 and is the direct result of improved operations.

## pottruck health and fitness center

The Pottruck Center is a new multi-purpose activity area designed for campus sports totalling 115,000 square feet. The center is a state-of-the-art recreation facility located at 37th and Walnut Streets, in the heart of the campus, which serves the entire Penn community. The Pottruck Center includes a climbing wall, multi-purpose rooms for dance, martial arts, and aerobic activities, a golf simulator, spinning room, pro shop and juice bar.



## levine hall for computer and information science

The Melvin J. and Claire Levine Hall was dedicated on April 9, 2003. The building, which conveniently links the Towne and Moore Buildings, is now home to the Department of Computer and Information Science (CIS). Levine Hall, made possible by a major gift from the Levines and funding from the Air Force, doubled the space available for CIS. Levine Hall provides space for new faculty and their students, including departmental offices, an auditorium, and research laboratories.



## quad renovation

The Quad Renewal Project was completed this past September, and the old dormitories—designed by Cope and Sewardson and built between 1895 and 1900—have been reconfigured to create better spaces supporting College House life. They now feature new lobbies, computer labs, fitness rooms, music-practice rooms, lounges with kitchens, libraries, seminar rooms, and faculty master residences. Their original architectural features have been restored and infrastructure systems have been updated, including air-conditioning. Landscaping has also been enhanced.





# outlook

## SUMMARY AND FUTURE OUTLOOK

Fiscal year 2003 was a record breaking year on many fronts. In terms of our major revenue sources, research awards grew to record levels, while student quality and selectivity reached new heights. Despite softness in the economy, gift revenues were extremely resilient, while endowment returns exceeded benchmarks and matched spending levels. The Health System saw its third consecutive year of positive operating results, reflecting the strength of its management team and clinical staff.

Many benchmarks continue to reveal the University's strength; however, this is no accident. Indeed, it reflects the fortitude of the "People of Penn", our Trustees, students, faculty, administration, alumni...all of whom have strived to take Penn to new heights. In recognizing Penn's dedicated and talented people, one special person must be acknowledged. Since 1994, Penn has been fortunate to have the leadership of an amazingly bright, dedicated, and energetic alumna, President Judith Rodin, CW66. Late in fiscal year 2003, Dr. Rodin announced her plan to step down from the presidency at the end of fiscal year 2004, upon completion of her tenth year at Penn. Dr. Rodin's tenure as Penn's President has been truly remarkable, as she led the institution with vision, leadership and energy to achievements not previously imagined. The long-term data included throughout this report help to reflect the dramatic changes accomplished during her tenure as President. Indeed, the quality of the institution she has managed will provide attractive and exciting opportunities for her successor and for Penn's many constituents.

In light of our accomplishments to date and the strategic plans for both the academic ("Building on Excellence") and health system ("Plan for PENN Medicine") components, the University is well-positioned for the future. While we are on a strong footing, we must maintain our focus to continue to excel. We recognize the challenges associated with the uncertainty in the economy, federal efforts to limit tuition price increases and the leveling off of the accelerated growth in NIH's budget, among other things. We believe the strength of our human, physical and financial capital will help us weather these challenges. As Franklin indicated, "To be thrown upon one's own resources, is to be cast into the very lap of fortune; for our faculties then undergo a development and display an energy of which they were previously unsusceptible."

As we complete another successful year, it is a stirring time to be associated with Penn. We look forward to the continued quality, motivation and resolve of the many talented and dedicated people of Penn who make this a proud and world class institution. Personally, I am grateful for the opportunity to be associated with such an outstanding institution and the many people who contribute to its success.



Craig R. Carnaroli  
Senior Vice President for Finance and Treasurer

## penn's urban campus »

A view of the Penn campus looking eastward.



## ▼ university commencement

The University Commencement honors the achievements of Penn's latest graduating class as well as the contributions Penn alums and others have made to society.



## ▲ dr. rodin

Judith Rodin, President of the University of Pennsylvania since 1994, will step down from the office when she completes her 10-year term in June 2004. During nearly a decade of service, Dr. Rodin has guided the University through a period of unprecedented growth and development that has transformed Penn's academic core and dramatically enhanced the quality of life on campus and in the surrounding community.





# a five-year review of investments

(thousands of dollars)

	2003	2002	2001	2000	1999
Investments:*					
Fair Value					
Stocks	\$1,553,708	\$1,689,648	\$1,902,998	\$1,695,205	\$2,181,568
Bonds**	1,198,993	1,183,923	915,088	1,321,508	962,844
Short-term**	348,703	303,812	343,810	348,561	449,797
Other	719,921	583,976	470,393	354,332	181,663
Total Investments	\$3,821,325	\$3,761,359	\$3,632,289	\$3,719,606	\$3,775,872
Endowment:					
Fair Value	\$3,547,473	\$3,393,297	\$3,381,848	\$3,200,712	\$3,281,306
Associated Investments Fund:					
Fair Value	\$2,859,041	\$2,772,040	\$2,800,390	\$2,556,597	\$2,661,621

\* Settlement date basis  
\*\* Excludes securities held as collateral under a securities lending program.

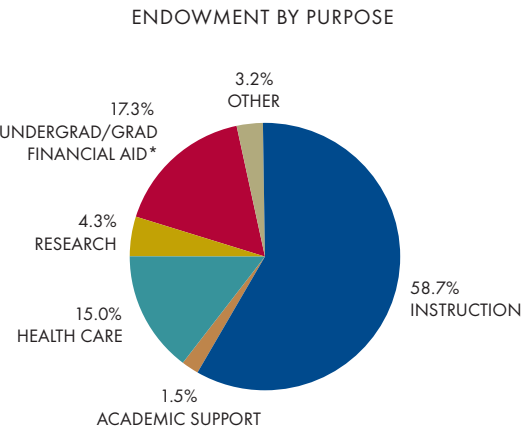


# endowment

### Total Endowment

The role of Penn’s endowment is to support its schools and centers by generating a growing, real (inflation-adjusted) flow of funds for the operating budget. At June 30, 2003, the endowment had a market value of \$3.547 billion and funded 3.7% of the University’s consolidated operating budget during the fiscal year. Penn’s total endowment includes individual endowments from all of our schools and centers, which serve a variety of purposes as shown in the chart below.

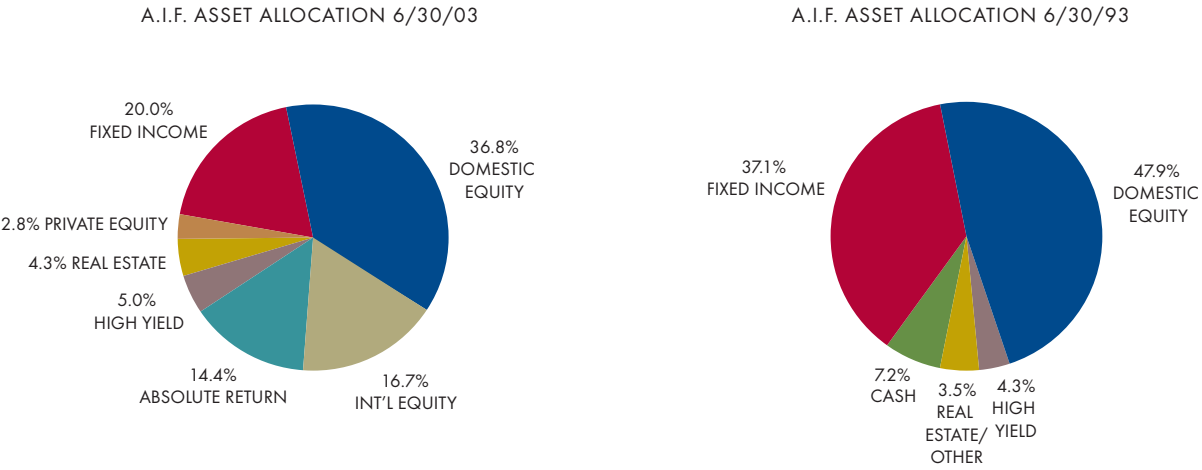
Over the fiscal year, the market value of the endowment increased by \$154 million. Increases to endowment included realized and unrealized gains from investments of \$52 million and net gifts and transfers of \$166 million. Reductions to endowment came from spending rule liquidation of \$64 million.



\* Includes undergraduate direct grants and graduate direct grants and stipends

# associated investments fund

Penn’s asset allocation strategy, one of the major determinants of its long-run investment performance, is implemented through a pooled investment fund called the Associated Investments Fund (“A.I.F.”). The vast majority of the University’s endowment is invested in the A.I.F., which had a market value of \$2.859 billion as of June 30, 2003. The A.I.F. is managed externally by third parties to maximize total returns from both current income and capital appreciation, while assuming a tolerable level of risk. Over the years the University has strategically changed the A.I.F.’s asset allocation by increasing its diversification and reducing its dependence on long-only public domestic equities and bonds. This shift in asset allocation is illustrated below.



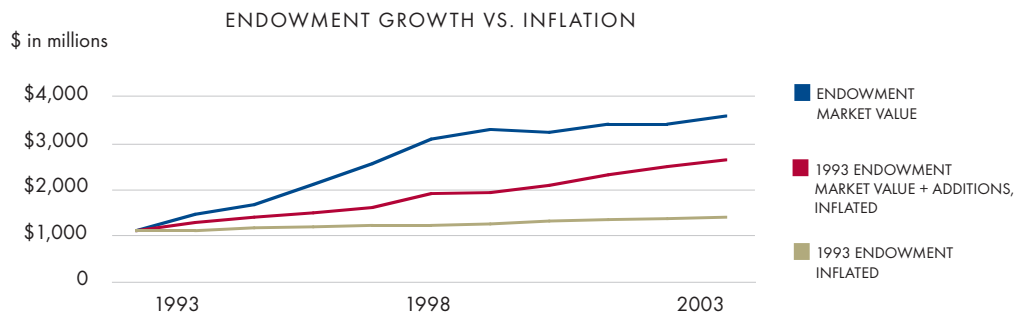
For fiscal 2003 the endowment generated an investment return of 4.7%, out-performing its composite benchmark by 1.1%. For comparison, a hypothetical portfolio invested 70% in the Wilshire 5000 stock index and 30% in the Lehman Government/Credit bond index would have produced 5.3% over the same period.

Compared to its peers, defined as other endowments with over \$1 billion in assets, Penn’s performance in fiscal 2003 is above the median return of 4.0% as reported by Cambridge Associates.

management responsibility for  
financial statements

associated investments fund

To illustrate the endowment’s real growth over time, the blue line in the following chart shows the growth in actual endowment value - including the impact of investment performance and gifts - reduced by spending contributed to the University. The red line shows the growth in endowment including gifts reduced by spending, but without the impact of investment performance. Finally, the tan line shows the value of the endowment, had it grown solely at the rate of inflation. This chart illustrates that the endowment’s investment performance has significantly added value over both gifts and inflation during the past ten years.



Investment performance over longer periods, compared to relevant benchmarks, is shown in the chart below.

Total Return Performance Comparison				
Periods Ended June 30, 2003				
Annualized Returns (%)				
Category	10 Years	5 Years	3 Years	1 Year
Associated Investments Fund (A.I.F.)	9.4	3.9	3.5	4.7
Composite Index *	8.4	1.6	-3.6	3.6
Wilshire 5000	9.5	-1.3	-10.6	1.3
Lehman Bros. Gov't./Credit Index	7.4	7.8	10.8	13.2
*The Composite Index is a benchmark that consists of the Wilshire 5000, EAFE, NCREIF, Lehman Gov't./Credit, and Citigroup High Yield indices in a weighting consistent with the A.I.F.'s policy asset allocation.				

A.I.F. Spending

The University’s endowment spending policy is designed to smooth the short-term impact of volatile capital markets that affect the endowment’s market value. Its goal is to make future endowment distributions more predictable for purposes of managing and planning the University’s operating budget. For fiscal year 2003, the spending policy is 4.7% of the three-year average market value of the A.I.F., lagged by one year. The market value of the A.I.F. is calculated net of all external management fees and net of the internal costs of managing the endowment.


During fiscal 2003 the total amount distributed under the spending policy was \$133.1 million, of which \$27 million was allocated for the common expenses (e.g., heat, light, maintenance) of the schools and centers benefiting from the endowment. Over the past decade, unitized spending has grown by 5.8% annually, well in excess of the rate of inflation.

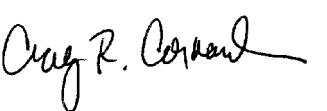
The management of the University of Pennsylvania is responsible for the preparation, integrity and fair presentation of the financial statements. The financial statements, presented on pages 33 to 51, have been prepared in accordance with generally accepted accounting principles and, as such, include amounts based on judgments and estimates by management. The University also prepared the other information included in this annual report and is responsible for its accuracy and consistency with the financial statements.


The financial statements have been audited by the independent accounting firm PricewaterhouseCoopers LLP, which was given unrestricted access to all financial records and related data, including minutes of all meetings of trustees. The University believes that all representations made to the independent auditors during their audit were valid and appropriate. PricewaterhouseCoopers’ audit opinion is presented on page 32.

The University maintains a system of internal controls over financial reporting, which is designed to provide a reasonable assurance to the University’s management and board of trustees regarding the preparation of reliable published financial statements. Such controls are maintained by the establishment and communication of accounting and financial policies and procedures, by the selection and training of qualified personnel, and by an internal audit program designed to identify internal control weakness in order to permit management to take appropriate corrective action on a timely basis. There are, however, inherent limitations in the effectiveness of any system of internal control, including the possibility of human error and the circumvention of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation. Furthermore, the effectiveness of an internal control system can change with circumstances.

The Trustees of the University of Pennsylvania, through its Committee on Audit and Compliance comprised of trustees not employed by the University, is responsible for engaging the independent auditors and meeting with management, internal auditors, and the independent auditors to ensure that each is carrying out their responsibilities. Both internal auditors and the independent auditors have full and free access to the Committee on Audit and Compliance.

  
Judith Rodin  
President

  
Craig R. Carnaroli  
Senior Vice President for Finance  
and Treasurer

  
Kenneth B. Campbell  
Comptroller



report of independent auditors

statement of financial position

(thousands of dollars)

To the Trustees of the  
University of Pennsylvania

In our opinion, the accompanying statement of financial position and the related statements of activities and of cash flows present fairly, in all material respects, the financial position of the University of Pennsylvania at June 30, 2003, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of University management; our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the University of Pennsylvania's 2002 financial statements; and in our report dated September 20, 2002, we expressed an unqualified opinion on those financial statements. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

September 29, 2003

Assets

Cash and cash equivalents  
Accounts receivable, net of allowances  
of \$10,162 and \$14,141  
Patient receivables, net of allowances  
of \$85,211 and \$91,507  
Contributions receivable, net  
Loans receivable, net of allowances  
of \$4,097 and \$4,020  
Other assets  
Investments, at fair value  
Plant, net of depreciation  
Total assets

Liabilities

Accounts payable  
Accrued expenses and other liabilities  
Collateral due broker  
Deferred income  
Deposits, advances, and agency funds  
Federal student loan advances  
Accrued retirement benefits  
Debt obligations  
Total liabilities

Net assets

Unrestricted  
Temporarily restricted  
Permanently restricted

Total liabilities and net assets

June 30, 2003	June 30, 2002
\$ 392,825	\$ 294,679
123,290	115,754
350,676	347,660
215,923	216,621
100,399	102,582
145,344	153,665
4,090,011	4,327,504
2,697,951	2,620,145
\$ 8,116,419	\$ 8,178,610
\$ 107,489	\$ 105,327
581,895	515,176
268,686	566,145
60,369	49,919
108,420	90,791
78,384	79,009
205,606	181,095
1,377,092	1,434,877
2,787,941	3,022,339
2,684,286	2,574,503
1,164,424	1,174,929
1,479,768	1,406,839
5,328,478	5,156,271
\$ 8,116,419	\$ 8,178,610

statement of activities

(thousands of dollars)

for the year ended June 30, 2003  
(with summarized financial information for the year ended June 30, 2002)

	Unrestricted	Restricted		2003	2002
		Temporarily	Permanently		
Revenue and other support:					
Tuition and fees, net	\$ 486,065			\$ 486,065	\$ 453,824
Commonwealth appropriations	44,302			44,302	42,174
Sponsored programs	646,674			646,674	579,727
Contributions	42,409	\$ 57,913		100,322	92,649
Investment income	81,767	84,588		166,355	171,060
Hospitals and physician practices	1,873,339			1,873,339	1,753,139
Sales and services of auxiliary enterprises	76,363			76,363	67,076
Other income	138,447			138,447	130,016
Independent operations	52,482			52,482	48,845
Net assets released from restrictions	147,757	(147,757)			
	3,589,605	(5,256)		3,584,349	3,338,510
Expenses:					
Program:					
Instruction	684,866			684,866	627,885
Research	526,130			526,130	483,163
Hospitals and physician practices	1,842,048			1,842,048	1,711,671
Auxiliary enterprises	96,899			96,899	87,455
Other educational activities	108,084			108,084	98,606
Student services	37,477			37,477	37,567
Support:					
Academic support	51,240			51,240	51,193
Management and general	164,881			164,881	152,698
Independent operations	51,127			51,127	57,356
	3,562,752			3,562,752	3,307,594
Increase (decrease) in net assets before nonoperating revenue, net gains, reclassifications and other	26,853	(5,256)		21,597	30,916
Nonoperating revenue, net gains, reclassifications and other:					
Gain (loss) on investment, net	21,116	26,851	\$ 7,260	55,227	(106,649)
Investment income, net of amounts classified as operating revenue	(3,693)	(43,440)	873	(46,260)	(23,622)
Contributions	24,049	57,764	64,796	146,609	224,926
Additional minimum pension liability	(4,966)			(4,966)	
Net assets released from restrictions	46,424	(46,424)			
Increase (decrease) in net assets	109,783	(10,505)	72,929	172,207	125,571
Net assets, beginning of period	2,574,503	1,174,929	1,406,839	5,156,271	5,030,700
Net assets, end of period	\$2,684,286	\$1,164,424	\$1,479,768	\$5,328,478	\$5,156,271

The accompanying notes are an integral part of these financial statements.

statement of cash flows

(thousands of dollars)

for the years ended June 30, 2003 and 2002

	2003	2002
Cash flows from operating activities:		
Increase in net assets	\$172,207	\$125,571
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	199,028	184,406
Provision for bad debts	118,013	125,634
(Gain) loss on investments, net	(55,227)	106,649
Loss (gain) on disposal of plant, property and equipment	1,042	(5,039)
Nonoperating income designated for the acquisition of long-lived assets and long-term investment	(100,349)	(201,304)
Additional minimum pension liability	4,966	—
Changes in operating assets and liabilities:		
Patient, accounts and loans receivable	(141,054)	(98,479)
Contributions receivable	(695)	(4,910)
Other assets	(10,289)	(7,712)
Accounts payable, accrued expenses and accrued retirement benefits	99,832	26,121
Deposits, advances and agency funds	17,629	11,566
Deferred income	10,450	3,527
Net cash provided by operating activities	315,553	266,030
Cash flows from investing activities:		
Student loans repaid	21,929	15,999
Student loans issued	(17,511)	(15,699)
Purchase of investments	(5,754,960)	(6,902,328)
Proceeds from sale of investments	5,756,571	6,651,066
Purchase of plant, property and equipment	(274,510)	(290,475)
Net cash used by investing activities	(268,481)	(541,437)
Cash flows from financing activities:		
Proceeds from contributions received designated for the acquisition of long-lived assets and long-term investment	109,564	215,284
Federal student loan advances	(625)	1,709
Repayment of long-term debt	(57,865)	(105,261)
Issuance of long-term debt	—	149,168
Net cash provided by financing activities	51,074	260,900
Net increase (decrease) in cash and cash equivalents	98,146	(14,507)
Cash and cash equivalents, beginning of period	294,679	309,186
Cash and cash equivalents, end of period	\$392,825	\$294,679
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 53,425	\$ 58,633
Non-cash activity		
Due to First Hospital Foundation	\$ 838	\$ 1,058

The accompanying notes are an integral part of these financial statements.



notes to financial statements

1. Significant Accounting Policies  
Organization

The University of Pennsylvania (the University), located in Philadelphia, Pennsylvania, is an independent, nonsectarian, not-for-profit institution of higher learning founded in 1740. The University Academic Component (Academic Component) provides educational services, primarily for students at the undergraduate, graduate, professional and postdoctoral levels and performs research, training and other services under grants, contracts and similar agreements with sponsoring organizations, primarily departments and agencies of the United States Government. The University also operates an integrated health care delivery system, the University of Pennsylvania Health System (UPHS). The University is a tax-exempt organization under Section 501(c) (3) of the Internal Revenue Code.

Basis of Presentation

The financial statements have been prepared on the accrual basis and include the accounts of the University of Pennsylvania and its subsidiaries. All material transactions between the University and its subsidiaries have been eliminated.

The net assets of the University are classified and reported as follows:

*Unrestricted* - Net assets that are not subject to donor-imposed restrictions.

*Temporarily restricted* - Net assets that are subject to legal or donor-imposed restrictions that will be met by actions of the University and/or the passage of time. These net assets include gifts donated for specific purposes and capital appreciation on permanent endowment, which is restricted by Pennsylvania law on the amounts that may be expended in a given year.

*Permanently restricted* - Net assets that are subject to donor-imposed restrictions that require the original contribution be maintained in perpetuity by the University, but permits the use of the investment earnings for general or specific purposes.

Expenses are reported as a decrease in unrestricted net assets. Gains and losses on investments are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions recognized on net assets are reported as net assets released from restrictions from temporarily restricted net assets to unrestricted net assets.

The financial statements include certain prior-year summarized comparative information in total, but not by net asset category. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the University's financial statements for the year ended June 30, 2002 from which the summarized information was derived. Certain reclassifications have been made to the summarized financial information for comparative purposes.

Cash and Cash Equivalents

Cash equivalents include short-term U.S. Treasury securities and other short-term, highly liquid investments and are carried at cost which approximates fair value. Short-term investments with maturities of three months or less when purchased are classified as cash equivalents, except that any such restricted investments are classified as investments.

Investments

Investments in equity and debt securities with readily determinable fair values are reported at fair value.

Changes in fair value of investments are reported in the University's Statement of Activities. Fixed income investments with a maturity of less than one year when purchased are included in short-term investments. Derivative financial instruments held for investment purposes are carried at fair value with the resulting gains and losses included in investment earnings for the period. The University's principal derivative financial instruments are forward mortgage contracts. Fair values for certain hedge funds, private equity and real estate investments held through limited partnerships or commingled funds are estimated by the respective external investment managers if market values are not readily ascertainable. These valuations necessarily involve assumptions and methods that are reviewed by the University. Restricted securities are valued at the last sale price at the valuation date with an illiquidity discount of 20 percent. In limited cases where fair values are not available for equity securities, historic cost, adjusted for impairment, if any, is used. Investments in entities which are not consolidated are reported in Other assets principally using the equity method.

The majority of the endowment funds of the University have been pooled in the University's Associated Investments Fund (A.I.F.), which is invested in equities, bonds, hedge funds, private equity and real estate limited partnerships. The University has adopted an endowment spending policy governing the expenditure of the total return of funds invested in the A.I.F. The spending policy is designed to manage annual spending levels and is independent of the cash yield and appreciation of investments for the year. For the fiscal years ended June 30, 2003 and June 30, 2002, the spending policy for the A.I.F. was 4.7% of the three year average market value lagged one year.

Loans Receivable

Student loans receivable are reported at their net realizable value. Such loans include donor-restricted and federally-sponsored student loans with mandated interest rates and repayment terms. Determination of the fair value of student loans receivable is not practicable.

Plant

Plant is stated at cost, or fair value at the date of donation, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the assets. Upon disposal of assets, the cost and related accumulated depreciation are removed from the accounts and the resulting net gain or loss is included in total expenses. Rare books and other collectibles are not depreciated.

Effective July 1, 2002, the University adopted SFAS No. 143 "Accounting for Asset Retirement Obligations." SFAS No. 143 requires the University to recognize the fair value of legal liabilities associated with the retirement of long-lived assets in the period in which the obligations are incurred. A corresponding amount is capitalized as part of the book value of the long-lived asset. The University has determined that it does not have a material obligation associated with the retirement of long-lived assets as described by this statement.

Intangible Assets

Intangible assets are included in Other assets in the accompanying Statement of Financial Position. Goodwill of \$36,502,000 at June 30, 2003 and \$38,161,000 at June 30, 2002 associated with the statutory merger of the Presbyterian Medical Center of Philadelphia into UPHS is being amortized over thirty years on a straight-line basis. Intangible assets including acquisition costs, the excess of cost over net assets acquired and non-competition agreements related to the acquisition of physician practices, net of accumulated amortization

notes to financial statements

were fully amortized at June 30, 2003 and were \$684,000 at June 30, 2002. These intangible assets were amortized on a straight-line basis over five years or the lives of the respective non-competition agreements.

Split-Interest Agreements

The University's split-interest agreements with donors consist primarily of charitable gift annuities, pooled income funds and irrevocable charitable remainder trusts for which the University serves as trustee. Assets are invested and payments are made to donors and/or other beneficiaries in accordance with the respective agreements.

Contribution revenue for charitable gift annuities and charitable remainder trusts is recognized at the date the agreement is established, net of the liability recorded for the present value of the estimated future payments. Contribution revenue for pooled income funds is recognized upon establishment of the agreement at the fair value of the estimated future receipts discounted for the estimated time period to complete the agreement.

The present value of payments to beneficiaries of charitable gift annuities and charitable remainder trusts and the estimated future receipts from pooled income funds are calculated using discount rates which represent the risk-free rates in existence at the date of the gift. Gains or losses resulting from changes in actuarial assumptions and accretions of the discount are recorded as increases or decreases in the respective net asset category in the Statement of Activities.

Tuition and Fees

The University maintains a policy of offering qualified undergraduate applicants admission to the University without regard to financial circumstance. This policy provides 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 certain grants

and scholarships in the amount of \$123,469,000 in 2003 and \$113,060,000 in 2002.

Sponsored Programs

The University receives grant and contract revenue from governmental and private sources. In 2003 and 2002, grant and contract revenue earned from governmental sources totaled \$548,329,000 and \$484,312,000, respectively. The University recognizes revenue associated with the direct costs of sponsored programs as the related costs are incurred. Indirect costs recovered on federally-sponsored programs are generally based on predetermined reimbursement rates negotiated with the University's cognizant federal agency, the Department of Health and Human Services. Indirect costs recovered on all other grants and contracts are based on rates negotiated with the respective sponsor. Funds received for sponsored research activity are subject to audit. Based upon information currently available, management believes that any liability resulting from such audits will not materially affect the financial position or operations of the University.

Contributions

Contributions are reported as increases in the appropriate net asset category based on donor restrictions. Contributions, including unconditional promises to donate, are recognized as revenue in the period received. Unconditional pledges are recognized at their estimated net present value, net of an allowance for uncollectible amounts, and are classified in the appropriate net asset category. Unconditional promises to donate and contributions of cash and other assets designated for the acquisition of long-lived assets and long-term investment are reported with nonoperating revenue, net gains, reclassifications and other.

Because of uncertainties with regard to their realizability and valuation, bequest intentions and other conditional

notes to financial statements

promises are not estimated by management and are recognized if and when the specified conditions are met.

Hospital and Physician Practices

Hospital and physician practices revenue is derived primarily from UPHS patient services and is accounted for at established rates on the accrual basis in the period the service is provided. Patient service revenue is net of charity care and community service. Certain revenue received from third-party payers is subject to audit and retroactive adjustment. Additionally, UPHS has entered into certain contracts under which it is responsible for providing medical care to covered members at predetermined rates. Any changes in estimates under these contracts are recorded in operations currently.

Allocation of Certain Expenses

The Statement of Activities presents expenses by functional classification. Operation and maintenance of plant and depreciation are allocated to functional classifications based on square footage. Interest expense is allocated to the functional classifications of the activity that directly benefited from the proceeds of the debt.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

2. University of Pennsylvania Health System - Summarized Financial Information

In 2002, the Trustees of the University of Pennsylvania formed Penn Medicine, the governance structure which

oversees the activities of UPHS and the University of Pennsylvania School of Medicine. The governing body operates, oversees and coordinates the academic, research and clinical missions of Penn Medicine. Penn Medicine replaced the prior multiple governing boards of UPHS and the School of Medicine, all of which were dissolved, with this single governing board.

UPHS is comprised of the Clinical Practices of the University of Pennsylvania, Clinical Care Associates, the Hospital of the University of Pennsylvania, the Presbyterian Medical Center of the University of Pennsylvania Health System, Phoenixville Hospital of the University of Pennsylvania Health System, Pennsylvania Hospital of the University of Pennsylvania Health System and Wissahickon Hospice of the University of Pennsylvania Health System. The activities of UPHS's risk retention program, supported and administered by Franklin Casualty Insurance Company, a wholly owned Risk Retention Group, and Quaker Insurance Company Ltd., a wholly owned offshore captive insurance company, (collectively referred to as RRG/Captive) are included in the combined financial statements.

Throughout the year, certain transactions are conducted between UPHS and the University. The effect of these transactions (primarily billings for allocations of common costs, physicians' salaries and benefits, certain purchased services and support for the School of Medicine) is included in the summarized financial information of UPHS. At June 30, 2003 and 2002, UPHS's net liability to the University was \$7,792,000 and \$24,938,000, respectively, for various inter-entity billings and is eliminated in the consolidated financial statements.

UPHS transferred to the School of Medicine from its operations \$37,006,000 and \$33,050,000 in 2003 and 2002, respectively, to further research and educational activities. These activities are integral to the overall mission of Penn Medicine and the effect of the transfers



notes to financial statements

is reflected in UPHS, nonoperating, net. This transaction is eliminated in the consolidated financial statements.

Final adjustments to revenue, resulting from settlements with third-party payers, are recorded in the year in which they are settled. Third party settlements decreased net patient revenue by \$6,824,000 and \$244,000 in 2003 and 2002, respectively.

In 2002, UPHS and Independence Blue Cross (IBC) reached agreement on terms of a five-year agreement. As part of this contract negotiation, there was a one-year deferral of original repayment terms set to begin in December 2002 for certain IBC

advances. The advances due IBC are reflected as liabilities, at their discounted value.

Payments made to Presbyterian Medical Center, Pennsylvania Hospital and Phoenixville Hospital for inpatient services provided to IBC traditional subscribers are effected on a per case rate basis for cardiac and orthopaedic surgery and on a per diem basis for all other services, while the Hospital of the University of Pennsylvania is paid based on an all inclusive per diem rate structure. The inpatient rates also provide for annual inflationary increases. Payment for outpatient services rendered to IBC traditional subscribers are principally based upon a percentage of billed charges.

Summarized financial information for UPHS as of June 30, 2003 and 2002, prior to eliminations for transactions between UPHS and other entities of the University, is as follows (in thousands):

	2003	2002
Net patient service	\$ 1,780,861	\$ 1,654,847
Other revenue	117,459	128,136
Total expenses	(1,855,986)	(1,728,873)
Excess of revenues over expenses from operations	42,334	54,110
Other unrestricted income, net	4,782	22,203
Excess of revenue over expenses	47,116	76,313
Nonoperating, net	(35,998)	(42,696)
Increase in net assets	\$ 11,118	\$ 33,617

notes to financial statements

	2003	2002
Total current assets	\$ 540,021	\$ 497,653
Assets whose use is limited (including board designated funds of \$283,704 and \$291,647 and trustee held funds of \$21,087 and \$28,247 for 2003 and 2002, respectively)	675,033	666,937
Plant, net of depreciation	624,369	607,789
Investments and other assets	63,517	55,435
Total assets	\$ 1,902,940	\$ 1,827,814
Total current liabilities	\$ 353,548	\$ 313,824
Long-term debt, net of current portion	775,027	799,048
Other liabilities	277,512	229,207
Total liabilities	1,406,087	1,342,079
Net assets		
Unrestricted	162,276	157,200
Temporarily restricted	237,286	233,503
Permanently restricted	97,291	95,032
Total net assets	496,853	485,735
Total liabilities and net assets	\$ 1,902,940	\$ 1,827,814

3. Investments

A summary of investments, stated at fair value, at June 30, 2003 and 2002 is as follows (in thousands):

	2003	2002
Investment sales receivable	\$ 49,010	\$ 93,456
Short-term	586,974	561,883
Stocks	1,551,988	1,682,464
Bonds	1,182,119	1,405,725
Real estate	133,386	171,924
Other	586,534	412,052
End of year	\$ 4,090,011	\$ 4,327,504
Beginning of year	\$ 4,327,504	\$ 3,883,036

Included in investments are assets held in trust for the University with an aggregate fair value of \$274,421,000 at June 30, 2003 and \$274,898,000 at June 30, 2002.

In connection with a University-sponsored loan program, the University is required to invest in certificates of deposit of the lending institution. At June 30, 2003 and

2002, short-term investments held under this arrangement aggregated \$4,486,000 and \$7,030,000, respectively.

At June 30, 2003 and 2002, investments with a fair value of \$36,660,000 and \$48,497,000, respectively, were held by trustees under indenture and escrow agreements.

notes to financial statements

Included in investments is \$930,000 and \$6,800,000 of cash that is held in escrow at June 30, 2003 and 2002, respectively.

At June 30, 2003 and 2002, investments with a fair value of \$261,637,000 and \$552,960,000, respectively, were loaned on an overnight basis to various brokers. The University receives lending fees and continues to earn interest and dividends on the loaned securities. These securities are returnable on demand and are collateralized by cash deposits and U.S. Treasury obligations. Cash deposits included in Short term investments are

\$238,271,000 and \$258,070,000 at June 30, 2003 and 2002, respectively. U.S. Treasury obligations included in Bonds are \$30,415,000 and \$308,075,000 at June 30, 2003 and 2002, respectively. The University is indemnified against borrower default by the financial institution that is acting as its lending agent.

At June 30, 2003 and 2002, short-term investment securities with a fair value of \$159,154,000 and \$158,633,000, respectively, have been earmarked for the purchase of other long-term investments.

A summary of the University's total investment return for the years ended June 30, 2003 and 2002 as reported in the Statement of Activities is presented below (in thousands):

	2003	2002
A.I.F. investment income	\$ 76,456	\$ 95,650
A.I.F. realized and unrealized gains and (losses)	57,576	(92,767)
Return on A.I.F.	134,032	2,883
Other investment income, gains and losses	41,290	37,906
Total return on investments	\$ 175,322	\$ 40,789

The A.I.F. returns available for expenditure in 2003 were \$132,963,000, which exceeded available investment income net of expenses by \$69,109,000. The A.I.F. returns available for expenditure in 2002 were \$130,904,000, which exceeded available investment income net of expenses by \$47,132,000.

4. Accounts Receivable

The major components of receivables, net of reserve for doubtful accounts of \$10,162,000 and \$14,141,000 at June 30, 2003 and 2002, respectively, were as follows (in thousands):

	2003	2002
Sponsored research	\$ 65,200	\$ 53,877
Student	20,471	15,008
Trade	19,636	24,807
Investment income	9,620	13,626
Other	8,363	8,436
Total Receivables	\$ 123,290	\$ 115,754

notes to financial statements

5. Contributions Receivable

A summary of contributions receivable is as follows at June 30, 2003 and 2002 (in thousands):

	2003	2002
Unconditional promises expected to be collected in:		
Less than one year	\$ 51,666	\$ 48,156
One year to five years	223,112	219,353
Over five years	7,213	12,661
	281,991	280,170
Less: Discount and allowance for doubtful amounts	(66,068)	(63,549)
Contributions receivable, net	\$ 215,923	\$ 216,621

6. Plant, Net of Depreciation

The components of plant at June 30, 2003 and 2002 are as follows (in thousands):

	2003	2002
Land	\$ 95,720	\$ 82,621
Buildings (a)	3,036,569	2,761,318
Contents	1,489,270	1,264,652
Construction-in-progress	110,750	358,530
	4,732,309	4,467,121
Less: accumulated depreciation	(2,034,358)	(1,846,976)
Plant, net of depreciation	\$ 2,697,951	\$ 2,620,145

(a) Includes \$84,859,000 and \$82,337,000 at June 30, 2003 and 2002, respectively, of completed facilities which serve as collateral for debt obligations.

The University recorded \$195,864,000 and \$179,819,000 of depreciation expense for the years ended June 30, 2003 and 2002, respectively. Rare books and other collectibles aggregating \$19,712,000 at June 30, 2003 and \$18,533,000 at June 30, 2002 are not subject to depreciation.

7. Split-Interest Agreements

The liability to donors and beneficiaries under terms of split-interest agreements included in Accrued expenses and other liabilities is as follows (in thousands):

	2003	2002
Charitable gift annuities	\$ 22,257	\$ 21,186
Charitable remainder trusts	20,807	17,624
Pooled income funds	886	1,181
Total split-interest agreements	\$ 43,950	\$ 39,991



notes to financial statements

8. Debt Obligations

Debt obligations at June 30, 2003 and 2002 are as follows (in thousands):

	Maturity	Interest Rate at June 30, 2003	June 30, 2003	June 30, 2002
Academic Component:				
Fixed Rate Debt Obligations:				
Pennsylvania Higher Education Facility Authority (PHEFA)				
Series of 1968 Ware College House	—	—	\$ —	\$ 11
Series A of 1995 Revenue Bonds	09/2015	5.3% - 7.0%	87,950	92,285
Series B of 1995 Revenue Bonds	09/2015	5.3% - 7.0%	39,575	41,525
Series of 1998 Revenue Bonds	07/2038	4.5% - 5.5%	192,670	194,630
Unamortized Discount			(1,943)	(2,020)
Series A of 2002 Revenue Bonds	07/2008	3.0% - 5.0%	16,825	16,825
Unamortized Premium			537	759
Department of Education Bonds	03/2007	3.0%	253	313
Other Loans	Various	3.0% - 8.0%	11,131	11,578
Mortgage Notes	Various	8.0%	7,777	8,089
Total Fixed Rate Debt Obligations			354,775	363,995
Variable Rate Debt Obligations:				
PHEFA				
Series of 1985 Revenue Bonds	12/2015	1.1%	10,610	10,610
Series of 1990 Revenue Bonds	12/2020	1.1%	6,500	6,500
Series B of 2002 Revenue Bonds	07/2032	1.1%	50,300	50,300
Quakertown General Authority				
Pool Financing	05/2005	1.0%	71,745	71,745
Washington County Authority				
Lease Revenue Bonds	11/2005	1.1%	55,252	57,460
Pennsylvania Economic Development Financing Authority				
Other Loans	Various	1.4% - 1.6%	16,567	16,724
Total Variable Rate Debt Obligations			210,974	233,579
Total Academic Component Debt Obligations			565,749	597,574
UPHS:				
Fixed Rate Debt Obligations:				
PHEFA				
Series A of 1994 Revenue Bonds	01/2010	5.6% - 7.0%	31,660	35,000
Unamortized Premium			465	538
Series A and B of 1996 Revenue Bonds	01/2022	5.0% - 6.0%	376,125	390,235
Unamortized Discount			(2,300)	(2,400)
Series A of 1998 Revenue Bonds	01/2015	4.4% - 5.4%	38,750	38,750
Unamortized Premium			610	661
Series of 2002 Revenue Bonds	01/2024	7.5%	26,065	26,065
Notes Payable	10/2005	7.0%	11,408	14,725
Capital Leases	Various	4.6% - 5.9%	26,949	31,331
Total Fixed Rate Debt Obligations			509,732	534,905

notes to financial statements

	Maturity	Interest Rate at June 30, 2003	June 30, 2003	June 30, 2002
Variable Rate Debt Obligations:				
PHEFA				
Series B of 1994 Revenue Bonds	06/2024	1.1%	\$ 90,000	\$ 90,000
Series C of 1996 Revenue Bonds	01/2026	1.1%	80,000	80,000
Series B of 1998 Revenue Bonds	01/2026	1.1%	121,600	121,600
Pennsylvania Economic Development Financing Authority Series C of 1994 Revenue Bonds				
	09/2014	2.0%	9,083	9,583
Mortgage Notes	01/2007	5.3%	928	1,215
Total Variable Rate Debt Obligations			301,611	302,398
Total UPHS Debt Obligations			811,343	837,303
Total University Debt Obligations			\$ 1,377,092	\$ 1,434,877

The fair value of the University's debt obligations was \$1,458,584,000 and \$1,461,369,000 at June 30, 2003 and 2002, respectively. The fair value represents the quoted market value for PHEFA Revenue Bonds and Department of Education Bonds and carrying amounts for all other debt, which approximates fair value.

Maturities of debt obligations for each of the next five years are as follows (in thousands):

Fiscal Year	Amount
2004	\$ 44,568
2005	118,098
2006	97,050
2007	46,393
2008	49,287

Academic Component

On August 1, 2002, the \$20,240,000 Pennsylvania Economic Development Financing Authority Revenue Bonds, Series 2001A dated August 1, 2001, were retired, as the pre K-8 school in University City constructed with these bond proceeds was sold to the School District of Philadelphia. These bonds had been issued August 1, 2001 and their proceeds loaned pursuant to a Loan Agreement dated August 1, 2001, to University City Associates, Inc. (UCA), a wholly-owned subsidiary of the University. UCA used the bond proceeds for the construction of the pre K-8 University-assisted public school in the West Philadelphia area, referenced above.

On February 28, 2002, the Pennsylvania Higher Educational Facilities Authority (the Authority) issued Revenue Bonds, Series 2002A, with an aggregate principal amount of \$16,825,000. The proceeds were used to refund the Series 1968 bonds, which were redeemed on April 4, 2002. The Series 2002A bonds mature in varying annual amounts ranging from \$2,235,000 in 2003 to \$2,435,000 in 2008. The bonds are subject to extraordinary special redemption by the Authority at a price equal to 100% of the principal amount plus accrued interest to the redemption date.

On February 28, 2002, the Authority issued Revenue Bonds, Series 2002B, with an aggregate principal amount of

notes to financial statements

\$50,300,000. The proceeds are to be used to renovate, rehabilitate, improve and equip existing University facilities (including dormitory renovations and sprinkler installations), construct new facilities and finance miscellaneous capital expenditures. The Series 2002B bonds mature on July 1, 2032. The bonds are subject to optional redemption by the Authority at the principal amount plus accrued interest to the date of redemption. The bonds are subject to Mandatory Sinking Fund Redemption in payment amounts ranging from \$675,000 in 2003 to \$2,100,000 in 2032. The Bonds bear a floating rate of interest, which is reset by dutch auction every 35 days. The Authority has the option to convert the interest rate on the Bonds to a fixed rate.

UPHS

The PHEFA Revenue Bonds, exclusive of Series of 2002, were issued under UPHS's Master Trust Indenture (MTI). The MTI and related agreements contain certain restrictive covenants which limit the issuance of additional indebtedness, and among other things, require UPHS to meet an annual debt service coverage requirement of "income available for debt service" (excess of revenue over expenses plus depreciation, amortization, interest expense and extraordinary items) at an amount equal to 110% of the annual debt service requirements. If the coverage requirement for a particular year is not met, within six months of the close of that fiscal year UPHS must retain the services of a consultant to make recommendations to improve the coverage requirement. UPHS must also implement the recommendations of the consultant to the extent that they can be feasibly implemented. UPHS will not be considered to be in default of the provisions of the MTI so long as it has sufficient cash flow to pay total operating expenses and to pay debt service for the fiscal year. In both 2003 and 2002, UPHS met its debt service coverage requirement under the MTI.

On August 1, 2002, UPHS renegotiated a three year reimbursement agreement with three financial institutions, whereby these institutions have agreed to provide letters

of credit for the principal amount of the bonds, plus applicable interest coverage to support the PHEFA Series B of 1994, Series C of 1996 and Series B of 1998 outstanding variable rate bonds. The conditions under the reimbursement agreement permit a borrowing under the letter of credit in the event the bonds are not successfully remarketed. UPHS pays commitment fees on the unused amount of the letters of credit. The University has agreed to guarantee the obligations of UPHS under the reimbursement agreement with the financial institutions.

The Series of 2002, dated June 27, 2002 was issued to refinance an \$18,000,000 term loan, finance certain capital projects and to establish a debt service reserve fund. The bonds have a stated interest rate of 7.5%. The holder of the bonds will have the option to tender them to Phoenixville Hospital for purchase on June 27, 2005, as described in a put option agreement between the Hospital of the University of Pennsylvania and Clinical Practices of the University of Pennsylvania and Merrill Lynch Portfolio Management. The 2002 Bonds are also guaranteed by the Hospital of the University of Pennsylvania and the Clinical Practices of the University of Pennsylvania, for which they receive a guarantee fee. The put option and the guarantee reduce the net cost of funds to 3.5%. Simultaneously, UPHS entered into a three-year interest rate exchange agreement in order to convert a portion of this fixed rate borrowing into a variable interest rate. The interest rate exchange agreement was not entered into for trading or speculative purposes. Under the terms of the agreement, UPHS receives a fixed rate of 2.7% and pays a variable interest rate defined as the BMA municipal swap index on the notional principal amount of \$26,065,000.

In April 2002, UPHS entered into a \$30,000,000 tax exempt capital lease for the acquisition of various equipment. The lease has a seven-year term at a fixed interest rate of 4.6%. Semi-annual payments approximate \$2,534,000.

notes to financial statements

9. Natural Classification of Expenditures

Expenses incurred were for (in thousands):

	Compensation	Student Aid	Depreciation	Interest	Other Operating	Total
June 30, 2003						
Instruction	\$ 429,408	\$ 38,092	\$ 28,512	\$ 2,789	\$ 186,065	\$ 684,866
Research	292,374	7,309	33,896	8,664	183,887	526,130
Hospitals and physician practices	961,763	-	86,884	36,349	757,052	1,842,048
Auxiliary enterprises	21,735	-	10,638	5,043	59,483	96,899
Other educational activities	74,624	6	4,888	860	27,706	108,084
Student services	23,124	147	-	364	13,842	37,477
Academic support	23,549	-	18,837	814	8,040	51,240
Management and general	117,266	26	6,839	1,162	39,588	164,881
Independent operations	4,614	-	5,370	2,097	39,046	51,127
Total	\$ 1,948,457	\$ 45,580	\$ 195,864	\$ 58,142	\$ 1,314,709	\$ 3,562,752
June 30, 2002	\$ 1,796,777	\$ 39,753	\$ 179,819	\$ 63,585	\$ 1,227,660	\$ 3,307,594

10. Operating Leases

The University leases office space and equipment under operating leases expiring through October 2016. Rental expense for the years ended June 30, 2003 and 2002 totaling \$41,594,000 and \$37,584,000, respectively, is included in the accompanying Statement of Activities.

At June 30, 2003, future minimum lease payments under operating leases with remaining terms greater than one year were as follows (in thousands):

2004	\$ 31,295
2005	25,760
2006	22,546
2007	18,981
2008	15,420
Thereafter	51,134
Total minimum lease payments	\$ 165,136

11. Pension and Other Postretirement Benefit Costs

Retirement benefits are provided for academic employees and certain administrative and support personnel through a defined contribution plan. The University's policy with respect to its contribution is to provide up to 9% of eligible employees' salaries. The University's contributions amounted to \$45,148,000 in 2003 and \$41,309,000 in 2002.

The University has noncontributory defined benefit pension plans for substantially all other full-time employees. Benefits under these plans generally are based on the employee's years of service and compensation during the years preceding retirement. Contributions to the plans are made in amounts necessary to at least satisfy the minimum required contributions as specified in the Internal Revenue Service Code and related regulations.



notes to financial statements

Clinical Care Associates has a non-contributory defined contribution retirement plan covering all eligible employees. Clinical Care Associates has also established a non-qualified supplemental retirement plan to provide retirement benefits to a select group of physician employees. Contributions to these plans are based upon the annual compensation of the eligible employees. Retirement plan expense was \$3,311,000 and \$3,503,000 for 2003 and 2002, respectively.

In 2003, it was determined that an additional minimum pension liability of \$4,966,000 was required to account for an unfunded accumulated benefit obligation (ABO) relating to the Phoenixville Hospital Pension Plan. This was recorded as a nonoperating charge on the Statement of Activities for the year ended June 30, 2003.

The components of accrued benefit costs for pension benefits and other postretirement benefits are as follows (in thousands):

	Pension Benefits		Other Postretirement Benefits	
	2003	2002	2003	2002
Change in benefit obligation:				
Benefit obligation at beginning of fiscal year	\$ 486,539	\$ 430,101	\$ 276,066	\$ 241,042
Service cost	14,433	12,505	10,414	12,652
Interest cost	34,581	31,676	18,627	18,776
Plan participants' contributions	—	—	2,398	701
Amendments	5,058	12,833	—	(22,651)
Actuarial loss	121,135	17,951	30,363	38,553
Benefits paid	(18,649)	(18,527)	(14,186)	(13,007)
Benefit obligation at end of fiscal year	\$ 643,097	\$ 486,539	\$ 323,682	\$ 276,066
Change in plan assets:				
Fair value of plan assets at beginning of fiscal year	\$ 518,975	\$ 534,339	\$ 71,377	\$ 74,858
Actual return on plan assets	20,414	3,163	3,854	(7,080)
Employer contribution	917	—	17,047	6,529
Plan participants' contributions	—	—	738	185
Benefits paid	(18,649)	(18,527)	(14,185)	(3,114)
Fair value of plan assets at end of fiscal year	\$ 521,657	\$ 518,975	\$ 78,831	\$ 71,378
Reconciliation of funded status:				
Funded status	\$ (121,620)	\$ 32,436	\$ (244,851)	\$ (204,689)
Unrecognized net actuarial loss (gain)	107,802	(35,854)	100,315	68,979
Unrecognized prior service cost (benefit)	16,551	12,927	(26,113)	(30,120)
Unrecognized transition asset	(268)	(1,680)	—	—
Net amount recognized	\$ 2,465	\$ 7,829	\$ (170,649)	\$ (165,830)
Amounts recognized on balance sheet:				
Prepaid pension cost				
in Other assets	\$ 32,527	\$ 18,462	\$ —	\$ —
Accrued retirement benefits	(30,062)	(10,633)	(170,649)	(165,830)
	\$ 2,465	\$ 7,829	\$ (170,649)	\$ (165,830)

Accrued retirement benefits includes \$4,897,000 and \$4,633,000 for faculty early retirement program at June 30, 2003 and June 30, 2002, respectively.

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Weighted-average assumptions as of June 30, 2003 and 2002:

	2003	2002
Discount rate	6.00%	7.25%
Expected return on plan assets	8.375%	9.25%
Rate of compensation increase	4.00 - 4.75%	4.00 - 4.75%

In 2003, the health care trend rate was assumed to decrease gradually from 7.5% to 5.0% over the next five years and remain level, thereafter. In 2002, the health care trend rate was assumed to decrease gradually from 8.0% to 5.0% over the subsequent six years.

The components net periodic benefit cost for pension benefits and other postretirement benefits are as follows (in thousands):

	Pension Benefits		Other Postretirement Benefits	
	2003	2002	2003	2002
Service cost	\$ 14,433	\$ 12,505	\$ 10,414	\$ 12,652
Interest cost	34,581	31,676	18,627	18,776
Expected return on plan assets	(42,701)	(48,942)	(6,089)	(7,237)
Amortization of prior service cost	1,435	41	(4,007)	(1,338)
Amortization of transition asset	(974)	(974)	—	—
Amortization of net actuarial gain	(493)	(4,946)	2,920	321
Net periodic cost (benefit)	\$ 6,281	\$ (10,640)	\$ 21,865	\$ 23,174

Assumed health care cost trend rates have a significant effect on the amounts reported for the other postretirement benefits. A one-percentage-point change in assumed health care trend rates would have the following effects on other postretirement benefits:

	1-Percentage Point Increase	1-Percentage Point Decrease
Effect on total of service and interest cost	\$ 4,845	\$ (3,820)
Effect on accumulated postretirement benefit obligation	\$ 44,086	\$ (36,407)

Pension plan assets consist principally of investments in a master trust account, invested in a diversified portfolio of equity and debt securities. Other postretirement employee benefit plan assets consist principally of investments in a diversified portfolio of equity and debt securities.

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12. Medical Professional Liability Claims

The University is insured for medical professional liability claims through the combination of the Medical Care Availability and Reduction of Error Fund (Mcare, formerly, the Medical Professional Liability Catastrophe Loss Fund of the Commonwealth of Pennsylvania -- CAT Fund), various commercial insurance companies and a risk retention program.

Mcare levies health care provider surcharges, as a percentage of the Pennsylvania Joint Underwriters Association rates for basic coverage, to pay claims and pay administrative expenses of Mcare participants. These surcharges are recognized as expenses in the period incurred. In March 2002, the Pennsylvania General Assembly approved reforming the Commonwealth's medical malpractice insurance system. No provision has been made for any future Mcare assessments in the accompanying financial statements as the University's portion of the unfunded Mcare liability cannot be estimated.

The University accrues for estimated retained risks arising from both asserted and unasserted medical professional liability claims. The estimate of the liability for unasserted claims arising from unreported incidents is based on analysis of historical claims data by an independent actuary which is recorded utilizing a 5.0% discount rate at June 30, 2003.

Assets have been board designated to provide funding for the University's retained risk associated with medical professional liability claims occurring prior to June 30, 1997, under its risk retention program. The assets are included in the accompanying financial statements.

From July 1998 through June 2001, the University was insured by a commercial insurer to provide claims made primary layer coverage on a claims-made premium basis. Premiums were expensed in each respective fiscal year.

Additionally, the University has recorded the actuarially determined exposure for unreported and unasserted medical professional claims that occurred during the period covered by the commercial insurance policy.

Effective July 1, 2001, the University funded RRG/Captive, for purposes of administering its risk retention program, covering its primary layer exposures. The assets and respective liabilities of RRG/Captive are included in the accompanying financial statements.

13. Contingencies, Guarantees and Commitments

On November 25, 2002, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 requires that upon issuance or modification of a guarantee, after December 31, 2002, the University must recognize a liability for the fair value of the obligation it assumes under that guarantee.

The University has guaranteed certain obligations as follows (in thousands):

	Amount Guaranteed	Recognized Liability
Mortgage Loans	\$ 25,725	\$ 225
Student Loans	144,357	12,304
Other	9,377	456
	<u>\$ 179,459</u>	<u>\$ 12,985</u>

To encourage home ownership and home improvement in the University's geographic area, certain employee mortgage loans are guaranteed. Upon default by the borrower the University may be required to pay any loss incurred following the lender's foreclosure process or the University may be required to purchase the loan. If the University purchases the loan, it will work with the borrower to make the loan current or it may foreclose and recover a portion of any loan from the

notes to financial statements

sale of the mortgaged property. Of the amount guaranteed, \$8,640,000 is estimated to be recoverable from subsequent sale of underlying assets the University would acquire if it performed under the guarantees. The University does not anticipate that any significant net payments will result from these guarantees. The recognized liability reflects the fair value of guarantees issued after December 31, 2002.

The University offers various loan programs for students and families to pay tuition, fees and other costs. Certain loans issued by private lending institutions are guaranteed by the University. Upon default by the borrower, the University is required to pay all or a portion of the outstanding loan balance. Of the amount guaranteed, \$26,959,000 is estimated to be recoverable from subsequent collection efforts on loans the University would acquire if it performed under the guarantees. A liability is recognized for the estimated net payments that will result from the portfolio of guaranteed loans. The amount of the liability recognized for defaults in the portfolio of guaranteed loans exceeds the estimated fair value of the guarantee that is required to be recognized by FIN 45.

The Other category principally includes guarantees of indebtedness for certain businesses in the University's geographic area whose activities benefit employees,

students and the community. The University does not anticipate that any significant net payments will result from these guarantees. Of the amount guaranteed, \$5,303,000 is estimated to be recoverable from subsequent sale of underlying assets the University would acquire if it performed under the guarantees and from other partners in the business. The recognized liability reflects the fair value of guarantees issued after December 31, 2002.

Various lawsuits, claims and other contingent liabilities arise in the ordinary course of the University's education and health care activities. Based upon information currently available, management believes that any liability resulting therefrom will not materially affect the financial position or operations of the University.

The University is currently involved in various capital projects that have resulted in capital commitments from the University. As of June 30, 2003, approximately \$75,254,000 has been committed by the University.





trustees

as of June 30, 2003

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Ms. Wendy Evans Joseph, FAIA  
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Mr. James J. Kim  
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statutory officers

as of June 30, 2003

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*Provost*  
Dr. Robert L. Barchi

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Major General Clifford L. Stanley (Ret.)

*Executive Vice President of the  
University of Pennsylvania for the Health  
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