During FY 03, the consolidated University achieved positive financial performance despite the uncertain economic climate. Penn concluded the fiscal year at June 30, 2003, with total assets of $8.1 billion, total liabilities of $2.8 billion, and net assets of $5.3 billion. Total net assets increased $172.2 million during the course of the fiscal year.

University’ total revenue increased $245.8 million, or 7.4% to over $3.58 billion. The Health System constituted 49% (or $120.2 million) of this overall growth in revenue due to growth in adult admissions, patient volumes and overall patient activity and higher payment rates. Sponsored programs revenue (including indirect cost recovery), principally in the School of Medicine, grew $66.9 million, or 11.5%, year-over-year. Tuition and fees (net of student aid) grew $32.2 million (7.1%).

Contributions continued its positive growth as signs of an improving economy began to materialize during the fourth quarter. Total gifts and pledges (excluding private grants) approached $247 million in FY 03. Operating contributions grew $7.7 million or 8.3% over FY 02 levels. Non-operating contributions – which includes gifts for endowment and capital – declined by $78.3 million due to the recording of the $100 million Annenberg Supporting Organization irrevocable trust in FY 02. Adjusting for this significant gift results in a $21.7 million (+17.4%) increase in FY 03 non-operating contributions.

Overall, total expenses increased $255.2 million or 7.7%. Consistent with accounting guidelines, expenses in the University’s audited financial statements are reported on a “functional” basis. Hospital and physician practice expenses accounted for 51% of total growth, increasing $120.2 million or 6.9%. Instruction and research-related expenses both grew at an approximate 9% rate of growth. Management and general expenses increased $12.2 million, or 8.0%, primarily due to increases in professional salaries, external insurance costs and depreciation.

Within the footnotes to the financial statements, the consolidated University expenses are reported on a “natural” classification basis. Overall, compensation (salary and benefits) increased 8.4% over FY 02 levels. Salaries experienced an increase of 8.2%, or $119.6 million, principally due to increased sponsored program activity at the University, and budgeted increases in the annual salary increase pool at both the University and Health System. Employee benefit costs increased 9.3% or $31.6 million over the prior year. The Health System accounted for 76% of the increase due to increased pension and medical costs. At the academic component of the University, employee benefits costs moderated over the prior year’s growth, principally due the effectiveness of plan design changes particularly in the area of prescription drug benefits.

The consolidated University achieved a positive increase in net assets from operating activities of $21.6 million, a decline of $9.3 million from FY 02. The decline can be attributed to higher utility costs at the University and higher Health System operating costs such as employee benefit costs (principally, pension), provisions for doubtful accounts and malpractice expenses. For the third consecutive year, the Health System generated positive net income from operations.
Consolidated University net assets from non-operating activities increased by $150.6 million due principally to gifts for capital and endowment (referenced above) and positive investment performance.

The University's endowment performed well behind strong fourth quarter gains, achieving a return of 4.7%, which is coincidently equal to the University's spending rule. The AIF closed the fiscal year with a 4.7% gain, 110 basis points ahead of the composite benchmark, but 60 basis points behind the 70/30 (equity/fixed income) strategic benchmark because of the AIF's relative over-weight to equities. Reflecting on first fiscal quarter performance, when the Wilshire 5000 lost 17% and the AIF was down 8%, it was difficult to foresee then that Penn would post a third positive fiscal year return in a row. As a result, Penn's cumulative performance over the last three years is a gain of 11%, or about 3.5% compounded per annum on average. Over the same period, the composite benchmark's cumulative performance is a loss of 10.4% and the 70/30's is a loss of 11%.

Asset classes which performed particularly well included investment grade bonds (due to the decline in long-term interest rates), high yield bonds (the highest return producing asset class in the portfolio), and absolute return which produced over 11% for the year. All of the strategies in the absolute return portfolio appeared to work well, particularly the distressed debt strategies.

Short-term working capital, measured by operating cash, grew by $78.8 million in part to advances received on grants and improvements in receivables at the University and improved patient receivables collections at the Health System. Days in accounts receivable at the Health System declined to 73.6 days at June 30, 2003.

Plant assets (reported on the balance sheet) increased by $77.8 million, net of depreciation of $193.2 million. Significant capital expenditures incurred for the Academic Component in FY03 include: Huntsman Hall ($32.0 million), Quadrangle renovations ($16.5 million), Levine Hall ($12.4 million), and the Hamilton College House renovations ($12.3 million); for the Health System, PAH Building ($11.2 million), HUP routine spending on equipment ($10.1 million), HUP EP/Cath Labs ($7.7 million), and PHX Ambulatory Care Center ($6.2 million).

Long-term debt decreased by $57.8 million due to the retirement of the interim construction financing for the K-8 school and the scheduled retirement of University debt.

Cash flow from operating activities totaled $315.5 million and exceeded FY 02 levels by $49.5 million. Purchase of property, plant and equipment exceeded $274.5 million, a slight decrease of $16.0 million from FY 02 activity.

CONSOLIDATED ACADEMIC COMPONENT (For the fiscal year ended June 30, 2003)

The Academic Component of the University concluded the fiscal year at June 30, 2003 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.

In FY 03, 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, led by the School of Medicine (+$37.3 million) and the School of Arts and Science (+$7.7 million). Tuition and fees, net of direct scholarship aid, grew by $32.2 million over the prior fiscal year period representing 25% of the overall growth. Due to both increases in
the quality of the student body and a weakness in the economy, student aid increased at a faster rate (+$10.4 million, +9.2%) than tuition. Operating contributions represented the third largest contributor to overall revenue growth, exceeding $100 million for FY 03. Revenue growth was dampened by declines in other investment income of $2.1 million (due primarily to declines in interest rates and reduced dividends) and the Graduate Medical Education reimbursement for dental residents.

Total expenses increased $125.5 million, or 7.8%, fueled principally by the growth in salary and wages and current expenses. Salary and wages increased 9.0%, of which 3.3% was driven by salaries funded from grants. The benefits plan redesign (e.g. medical coverage and prescription plan) implemented in FY 02 helped reduce the rate of employee benefits expense growth to 3.6% in FY 03. In addition, interest expense declined by $2.4 million due to lower short term interest rates on variable rate debt and the refinancing of debt.

Net assets from operating activities increased by $13.6 million, a $5.3 million improvement over fiscal year 2002 levels. Total net assets from non operating activities increased by $147.5 million due principally to non-operating contributions.

Plant assets increased by $61.2 million, net of depreciation of $106.3 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. Amounts due from the Health System declined $17.1 million to $7.8 million. Liquidity – Working Capital increased by $80.0 million. Cash flow from operating activities increased by $14.6 million. Capital investment declined $34.3 million as several large-scale projects were completed (e.g. Huntsman Hall).

UNIVERSITY OF PENNSYLVANIA HEALTH SYSTEM – PENN MEDICINE
(For the fiscal year ended June 30, 2003)

In FY 03, the University of Pennsylvania Health System (UPHS) continued to perform favorably, achieving a positive operating margin for the third consecutive year since commencing its financial recovery program in FY 00. The excess of revenue over expenses from operations (excluding investment income) totaled $20.1 million, which was $7.2 million less than the prior fiscal year.

The excess of revenue over expenses (including investment income) totaled $47.1 million and was lower than budget by $12.9 million. The lower than budget performance was primarily due to the recognition of unfavorable third party adjustments and increased malpractice and pension expenses.

The excess of revenue over expenses (including investment income) is before transfers to the University and School of Medicine ($37.1 million) and the recognition of the minimum pension liability (resulting from Phoenixville Hospital’s accumulated pension benefit obligation exceeding the market value of its pension plan assets). The net effect of the positive operating performance and transfers was an increase in unrestricted net assets of $5.1 million.

Operating revenue increased 7.0% largely due to favorable utilization trends and payment rates. Inpatient activity (adult admissions) grew 3.7%, while outpatient activity increased 3.8% (excluding CCA primary care network visits which declined as a result of planned divestitures) compared to the prior year. During fiscal 2003, the Independence Blue Cross contract was
renegotiated and favorably impacted net patient service revenue. UPHS also experienced increased intensity of service as measured by the Medicare Case Mix Index (CMI), particularly at HUP and Pennsylvania Hospital.

Operating expenses were higher than the comparable prior year period by $127.1 million (7.4%). Salaries and wage increased 7.4% due to the budgeted FY 03 salary increase program. Employee benefits increased 17.5% driven by higher pension expenses (associated with the assumption of a lower long-term investment rate of 8.375% and a lower discount rate for liabilities of 6%) and medical costs. Supplies and services increased 6.5% due to increased patient activity and usage of drug and blood products (volume and programmatic requirements). Malpractice expenses increased 32.9% as UPHS became fully self-insured in fiscal year 2003 due to the absence of a cost effective commercial alternative.

UPHS continued its efforts to increase strategically targeted programmatic capital investments that had been previously deferred. Purchases of property and equipment reached $97.7 million for FY 03, exceeding the level for FY02 ($80.0 million) and actual FY 03 depreciation ($89.9 million). Operating cash flow of $174.6 million represents a slight increase from the prior year as accounts receivable collections continue to decline (73.6 days compared to prior year levels of 75.6 days).

Short-term liquidity, as measured by operating cash and short-term investments, was stable at $91.8 million. This stability was achieved despite the increase in capital spending, transfers to the School of Medicine ($37.0 million) and to the University ($5.1 million), and a reduction in Health Service’s liability to the University ($17.1 million) in accordance with the agreed upon repayment schedule.

Long-term debt and notes payable (current and long-term) decreased $26.0 million. The Health System’s debt-to-capitalization ratio declined from 84% to 83% due to the repayments, as well as to a $5.1 million increase in unrestricted net assets. During FY 03, the Health System renewed a three year letter of credit ($291.6 million) supporting the Health System’s variable rate debt. The Health System’s letter of credit reimbursement obligations are supported by a University guaranty.