

# **Mercyhurst College**

Accountants' Report and Financial Statements

June 30, 2005 and 2004



**Mercyhurst College**  
**June 30, 2005 and 2004**

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## Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Trustees  
Mercyhurst College  
Erie, Pennsylvania

We have audited the accompanying statement of financial position of Mercyhurst College as of June 30, 2005, and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the College's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Mercyhurst College as of and for the year ended June 30, 2004, were audited by other accountants whose report dated September 10, 2004, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2005 financial statements referred to above present fairly, in all material respects, the financial position of Mercyhurst College as of June 30, 2005, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 2, 2005, on our consideration of the College's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the 2005 basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the 2005 basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the 2005 basic financial statements taken as a whole.

*BKD, LLP*

September 2, 2005

**Mercyhurst College**  
**Statements of Financial Position**  
**June 30, 2005 and 2004**

**Assets**

	<b>2005</b>	<b>2004</b>
Cash and cash equivalents	\$ 7,976,555	\$ 7,962,995
Accounts receivable, net of allowance; 2005 - \$306,356, 2004 - \$440,204	1,659,761	1,655,290
Contributions receivable, net	747,189	1,680,308
Receivable from charitable remainder trust	450,089	552,796
Loans receivable, net of allowance of \$139,270	2,489,851	2,347,260
Inventories	366,648	300,648
Prepaid expenses and other assets	573,546	643,682
Bond discount and issuance costs, net	396,239	614,511
Deposits with trustees	2,360,470	6,891,772
Long-term investments	14,720,849	12,056,436
Land, buildings and equipment, net	<u>68,020,542</u>	<u>57,723,758</u>
Total assets	<u>\$ 99,761,739</u>	<u>\$ 92,429,456</u>

**Liabilities and Net Assets**

**Liabilities**

Accounts payable	\$ 3,410,743	\$ 2,406,048
Accrued expenses and other liabilities	3,051,156	2,281,085
Accrued interest	324,788	436,450
Student deposits	1,257,496	1,038,141
Deferred revenue	1,076,645	602,676
Notes payable	2,131,066	1,376,748
Bonds payable	33,690,000	34,470,000
Advances from Federal government for student loans	2,272,584	2,245,704
Trusts payable	<u>271,116</u>	<u>192,808</u>
Total liabilities	<u>47,485,594</u>	<u>45,049,660</u>

**Net Assets**

Unrestricted	36,946,240	33,066,168
Temporarily restricted	6,420,247	5,857,475
Permanently restricted	<u>8,909,658</u>	<u>8,456,153</u>
Total net assets	<u>52,276,145</u>	<u>47,379,796</u>
Total liabilities and net assets	<u>\$ 99,761,739</u>	<u>\$ 92,429,456</u>

**Mercyhurst College**  
**Statement of Activities**  
**Year Ended June 30, 2005**

	2005			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
<b>Revenues, Gains and Other Support</b>				
Tuition and fees	\$ 59,441,234	\$ —	\$ —	\$ 59,441,234
Less college funded financial aid	<u>20,601,954</u>	<u>—</u>	<u>—</u>	<u>20,601,954</u>
Net tuition and fees	38,839,280	—	—	38,839,280
Government grants and other contracts	6,473,855	—	—	6,473,855
Private gifts	426,146	610,299	429,665	1,466,110
Investment income	399,010	136,890	—	535,900
Realized and unrealized gains	462,641	623,343	—	1,085,984
Other revenues	1,178,897	—	—	1,178,897
Auxiliary enterprises	15,038,319	—	—	15,038,319
Change in value of split interest agreements	—	(147,862)	—	(147,862)
Net assets released from restrictions	641,058	(641,058)	—	—
Reclassification of net assets	<u>(5,000)</u>	<u>(18,840)</u>	<u>23,840</u>	<u>—</u>
Total revenues, gains and other support	<u>63,454,206</u>	<u>562,772</u>	<u>453,505</u>	<u>64,470,483</u>
<b>Expenses and Other Deductions</b>				
Instruction	18,127,567	—	—	18,127,567
Public service	245,027	—	—	245,027
Academic support	1,607,959	—	—	1,607,959
Student services	8,491,988	—	—	8,491,988
Institutional support	10,564,020	—	—	10,564,020
Operation and maintenance of plant	5,474,479	—	—	5,474,479
Scholarships and fellowships	2,319,668	—	—	2,319,668
Auxiliary enterprises	8,596,167	—	—	8,596,167
Depreciation	2,892,981	—	—	2,892,981
Interest	<u>1,254,278</u>	<u>—</u>	<u>—</u>	<u>1,254,278</u>
Total expenses and other deductions	<u>59,574,134</u>	<u>—</u>	<u>—</u>	<u>59,574,134</u>
<b>Change in Net Assets</b>	3,880,072	562,772	453,505	4,896,349
<b>Net Assets, Beginning of Year</b>	<u>33,066,168</u>	<u>5,857,475</u>	<u>8,456,153</u>	<u>47,379,796</u>
<b>Net Assets, End of Year</b>	<u>\$ 36,946,240</u>	<u>\$ 6,420,247</u>	<u>\$ 8,909,658</u>	<u>\$ 52,276,145</u>

**Mercyhurst College**  
**Statement of Activities**  
**Year Ended June 30, 2004**

	2004			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
<b>Revenues, Gains and Other Support</b>				
Tuition and fees	\$ 53,223,848	\$ —	\$ —	\$ 53,223,848
Less college funded financial aid	<u>17,755,345</u>	<u>—</u>	<u>—</u>	<u>17,755,345</u>
Net tuition and fees	35,468,503	—	—	35,468,503
Government grants and other contracts	5,790,040	—	—	5,790,040
Private gifts	414,864	1,012,103	1,352,344	2,779,311
Investment income	299,282	100,279	—	399,561
Realized and unrealized gains	310,086	814,399	—	1,124,485
Other revenues	1,010,434	—	—	1,010,434
Auxiliary enterprises	13,467,310	—	—	13,467,310
Change in fair value of derivative	42,924	—	—	42,924
Net assets released from restrictions	621,274	(621,274)	—	—
Reclassification of net assets	<u>(363,445)</u>	<u>313,444</u>	<u>50,001</u>	<u>—</u>
Total revenues, gains and other support	<u>57,061,272</u>	<u>1,618,951</u>	<u>1,402,345</u>	<u>60,082,568</u>
<b>Expenses and Other Deductions</b>				
Instruction	16,770,719	—	—	16,770,719
Public service	220,552	—	—	220,552
Academic support	1,492,679	—	—	1,492,679
Student services	7,750,716	—	—	7,750,716
Institutional support	6,842,014	—	—	6,842,014
Operation and maintenance of plant	4,815,097	—	—	4,815,097
Scholarships and fellowships	2,313,182	—	—	2,313,182
Auxiliary enterprises	7,846,931	—	—	7,846,931
Depreciation	2,652,394	—	—	2,652,394
Interest	<u>1,607,519</u>	<u>—</u>	<u>—</u>	<u>1,607,519</u>
Total expenses and other deductions	<u>52,311,803</u>	<u>—</u>	<u>—</u>	<u>52,311,803</u>
<b>Change in Net Assets</b>	4,749,469	1,618,951	1,402,345	7,770,765
<b>Net Assets, Beginning of Year</b>	<u>28,316,699</u>	<u>4,238,524</u>	<u>7,053,808</u>	<u>39,609,031</u>
<b>Net Assets, End of Year</b>	<u>\$ 33,066,168</u>	<u>\$ 5,857,475</u>	<u>\$ 8,456,153</u>	<u>\$ 47,379,796</u>

**Mercyhurst College**  
**Statements of Cash Flows**  
**Years Ended June 30, 2005 and 2004**

	<u>2005</u>	<u>2004</u>
<b>Operating Activities</b>		
Change in net assets	\$ 4,896,349	\$ 7,770,765
Items not requiring (providing) operating activities cash flows		
Depreciation and amortization	3,352,671	2,722,024
Net realized and unrealized gains on investments	(1,085,984)	(1,124,485)
Loss on disposal of land, buildings and equipment	245,162	—
Change in value of split interest agreements	147,862	—
Contributions received restricted for long-term investment	(429,665)	(1,115,084)
Changes in		
Receivables	786,057	184,418
Inventories	(66,000)	(21,900)
Prepaid expenses and other assets	70,136	(249,383)
Accounts payable	1,004,695	1,074,877
Accrued expenses and other liabilities	658,409	297,881
Student deposits	219,355	(61,205)
Deferred revenue	473,969	(270,150)
Advances from Federal government for student loans	<u>26,880</u>	<u>48,904</u>
Net cash provided by operating activities	<u>10,299,896</u>	<u>9,256,662</u>
<b>Investing Activities</b>		
Purchase of land, buildings and equipment	(13,434,927)	(6,108,337)
Purchase of long-term investments	(17,525,531)	(14,217,629)
Proceeds from disposition of long-term investments	15,980,255	12,007,433
Change in deposits with trustees	<u>4,531,302</u>	<u>(4,703,221)</u>
Net cash used in investing activities	<u>(10,448,901)</u>	<u>(13,021,754)</u>
<b>Financing Activities</b>		
Principal borrowings on bonds	18,365,000	5,475,000
Principal payments on bonds	(19,145,000)	(975,000)
Principal borrowings on notes payable	1,907,666	—
Principal payments on notes payable	(1,153,348)	(1,703,259)
Payments for bond issuance costs	(241,418)	—
Proceeds from contributions restricted for long-term investment	<u>429,665</u>	<u>1,115,084</u>
Net cash provided by financing activities	<u>162,565</u>	<u>3,911,825</u>
<b>Increase in Cash and Cash Equivalents</b>	13,560	146,733
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>7,962,995</u>	<u>7,816,262</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 7,976,555</u>	<u>\$ 7,962,995</u>
<b>Supplemental Cash Flows Information</b>		
Interest paid	\$ 1,365,940	\$ 1,569,146

**Mercyhurst College**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

**Note 1: Nature of Operations and Summary of Significant Accounting Policies**

***Nature of Operations***

Mercyhurst College (the College) operates as a private, not-for-profit institution in northwestern Pennsylvania. A majority of its students are from Pennsylvania and surrounding states. The majority of the College's revenues are derived from tuition and fees charged to students.

***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect 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 revenues, expenses, gains, losses and other changes in net assets during the reporting period. Actual results could differ from those estimates.

***Cash Equivalents***

With the exception of certain investments held in the endowment fund, the College considers all liquid investments with original maturities of three months or less to be cash equivalents. At June 30, 2005 and 2004, cash equivalents consisted primarily of money market funds. At June 30, 2005, the College's cash accounts exceeded federally insured limits by approximately \$7,950,000.

***Fair Value of Financial Instruments***

The College's financial instruments which include cash, cash equivalents, receivables, accounts payable, accrued expenses, and debt are carried at amounts which approximate fair value.

***Investments and Investment Return***

Investments in equity securities having a readily determinable fair value and all debt securities are carried at fair value. Other investments are valued at the lower of cost or fair value. Investment return includes dividend, interest and other investment income; realized and unrealized gains and losses on investments carried at fair value; and realized gains and losses on other investments.

The College maintains pooled investment accounts for its endowments. Investment income and realized and unrealized gains and losses from securities in the pooled investment accounts are allocated quarterly to the individual endowments based on the relationship of the fair value of the interest of each endowment to the total fair value of the pooled investments accounts, as adjusted for additions to or deductions from those accounts.

**Mercyhurst College**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

***Accounts Receivable***

Accounts receivable are stated at the amount of tuition, room and board and fees billed to students adjusted for the allowance for uncollectible accounts. Student receivables are normally due four weeks prior to the first day of each term. The College also offers payment plans which allow students to make three payments throughout the term, or nine payments throughout the year. Accounts that are unpaid after the due date may be subject to a late fee. A financial hold is placed on delinquent accounts, which bars a student from registering for any new classes until they make payment arrangements and bars a student from receiving transcripts or a diploma. The College provides an allowance for doubtful accounts, which is based upon a review of the outstanding student receivables along with current and historical collection information.

***Loans Receivable***

Student loans receivable under the Federal Perkins Loan Program are reported at the outstanding principal balances, net of allowance for collectibility. The repayment period begins after an initial grace period of nine months after the student ceases to be at least a half-time student. Interest income is recorded as monthly payments are received.

***Land, Buildings, and Equipment***

Land, buildings, and equipment are recorded at cost and depreciated on a straight-line basis over the estimated useful life of each asset. Repairs, maintenance and minor replacements of existing facilities are charged to expense as incurred.

***Temporarily and Permanently Restricted Net Assets***

Temporarily restricted net assets are those whose use by the College has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the College in perpetuity. Generally, the donors of these assets permit the College to use all or part of the income earned on related investments for general or specific purposes.

***Contributions***

Gifts of cash and other assets received without donor stipulations are reported as unrestricted revenue and net assets. Gifts received with a donor stipulation that limits their use are reported as temporarily or permanently restricted revenue and net assets. When a donor stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Gifts and investment income that are originally restricted by the donor and for which the restriction is met in the same time period are recorded as temporarily restricted and then released from restriction. Contributions other than cash are recorded at their estimated fair value.

**Mercyhurst College**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are reported at the present value of estimated future cash flows. The resulting discount is amortized and reported as contribution revenue using the level-yield method.

Conditional gifts depend on the occurrence of a specified future and uncertain event to bind the potential donor and are recognized as assets and revenue when the conditions are substantially met and the gift becomes unconditional.

An allowance for uncollectible contributions, which is based on management's judgment of the risks, is provided as a reduction of the amount of contributions received.

***Collections***

Collections of works of art, historical treasures and similar assets are not capitalized in as much as the items are preserved and cared for continuously. Contributions of collection items are not reported in the financial statements. The College's collections consist primarily of paintings, sculptures, and other works of art, books, and antique furniture.

***Inventory Pricing***

Inventories consist primarily of books, clothing, and other merchandise at the College's bookstores, and certain maintenance supplies, and are stated at the lower of cost or market using the first-in, first-out (FIFO) method.

***Advances from Federal Government for Student Loans***

The College administers Federally funded loan programs for the benefit of its students. This liability represents the amount that must be returned to the federal government upon termination of the program.

***Government Grants***

Support funded by grants is recognized as the College performs the contracted services or incurs outlays eligible for reimbursement under the grant agreements. Grant activities and outlays are subject to audit and acceptance by the granting agency and, as a result of such audit, adjustments could be required.

***Auxiliary Enterprises***

Revenues and expenditures from auxiliary enterprises include the student dormitories, food service, bookstore, special events, and outside sales. Certain indirect expenditures, such as depreciation and interest on indebtedness, are not charged to the auxiliary enterprises.

**Mercyhurst College**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

**Income Taxes**

The College is exempt from income taxes under Section 501(a) of the Internal Revenue Code (the Code) as an organization described under Section 501(c) of the Code, as well as a similar provision of state law. However, the College is subject to federal income tax on any unrelated business taxable income.

**Reclassifications**

Certain reclassifications have been made to the 2004 financial statements to conform with the 2005 financial statement presentation. The College also identified certain net asset fund balances that had been misclassified between unrestricted, temporarily restricted and permanently restricted during 2004 and 2003. The following net assets were reclassified in the 2005 and 2004 financial statements to appropriately recognize the restricted nature of certain net asset fund balances:

	<b>2005</b>	<b>2004</b>
Unrestricted	\$ (5,000)	\$ (363,445)
Temporarily restricted	(18,840)	313,444
Permanently restricted	23,840	50,001

The reclassifications had no effect on changes in net assets for 2005 and 2004.

**Note 2: Investments and Investment Return**

Investments, including deposits with trustees, at June 30 consisted of the following:

	<b>2005</b>	<b>2004</b>
Cash equivalents	\$ 472,743	\$ 816,629
U.S. Treasury securities	2,025,287	2,079,826
Collective fixed income funds	3,219,304	2,544,776
Collective equity funds	6,928,584	5,834,034
Guaranteed investment contract	—	4,700,001
Equity securities	3,353,730	2,537,440
Hedge fund-of-funds	657,669	—
Real estate	424,002	424,002
Other	—	11,500
	\$ 17,081,319	\$ 18,948,208

**Mercyhurst College**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

**Note 3: Contributions Receivable and Conditional Promises Received**

Contributions receivable at June 30 consisted of the following:

	<b>2005</b>	<b>2004</b>
Due within one year	\$ 873,623	\$ 782,243
Due in one to five years	182,102	904,552
Due in more than five years	200,000	373,116
	1,255,725	2,059,911
Less allowance for uncollectible contributions	(338,602)	(137,840)
Unamortized discount	(169,934)	(241,763)
	<b>\$ 747,189</b>	<b>\$ 1,680,308</b>

The discount rate used was 6.0% for 2005 and 2004.

As a result of the capital campaign, at June 30, 2005, the College has been named in will commitments totaling \$3,000,000, which are not reflected in the financial statements, as they are considered conditional promises to give.

**Note 4: Receivable from Charitable Remainder Trust**

The College is the beneficiary under a charitable remainder trust for which it is not the trustee. The College's beneficial interest in this trust is recorded at fair value, measured by the present value of the estimated expected future benefits to be received when the trust assets are distributed. At June 30, 2005 and 2004, the College's beneficial interest in remainder trusts administered by outside parties is \$450,089 and \$552,796, respectively.

**Mercyhurst College**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

**Note 5: Land, Buildings, and Equipment**

Land, buildings, and equipment at June 30 consists of:

	<b>2005</b>	<b>2004</b>
Land	\$ 3,333,484	\$ 1,021,249
Land improvements	7,800,522	6,419,496
Buildings	62,322,892	58,838,369
Furnishings and equipment	16,569,051	14,959,613
Library books	3,738,454	3,483,504
Construction-in-progress	<u>5,692,706</u>	<u>1,574,702</u>
	99,457,109	86,296,933
Less accumulated depreciation	<u>(31,436,567)</u>	<u>(28,573,175)</u>
	<u>\$ 68,020,542</u>	<u>\$ 57,723,758</u>

**Note 6: Accrued Expenses and Other Liabilities**

Accrued expenses and other liabilities at June 30, consist of:

	<b>2005</b>	<b>2004</b>
Accrued payroll and deferred compensation	\$ 2,381,926	\$ 1,569,049
Accrued payroll taxes and withholdings	58,352	186,106
Accrued vacation	429,566	350,820
Other accrued expenses	<u>181,312</u>	<u>175,110</u>
	<u>\$ 3,051,156</u>	<u>\$ 2,281,085</u>

**Note 7: Trusts Payable**

The College administers two charitable remainder trusts. A charitable remainder trust provides for the payment of distributions to the grantor or other designated beneficiaries over the trust's term (usually the designated beneficiary's lifetime). At the end of the trust's term, the remaining assets are available for the College's use. The portion of the trust attributable to the future interest of the College is recorded in the statements of activities as temporarily restricted contributions in the period the trust is established. Assets held in the charitable remainder trusts are recorded at fair market value in the College's statements of financial position. On an annual basis, the College revalues the liability to make distributions to the designated beneficiaries based on actuarial assumptions. The present value of the estimated future payments is calculated using discount rates available at the date of the trusts' inception which were 7.0% and 7.6% and applicable mortality tables.

**Mercyhurst College**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

**Note 8: Long-term Debt**

Long-term debt at June 30 consists of the following:

	<b>2005</b>	<b>2004</b>
Notes payable		
Line of Credit	\$ 1,999,921	\$ 576,921
Note payable - GMACRAT	67,231	778,977
Other	63,914	20,850
Total notes payable	2,131,066	1,376,748
 Bonds payable		
College Revenue Refunding Bonds Series A and B of 1993, with interest rates ranging from 5.30% to 5.75%	—	17,880,000
College Revenue Refunding Bonds of 1997, with interest rates ranging form 5.25% to 5.85%	2,380,000	2,515,000
Pennsylvania Higher Education Facilities Authority Revenue Bonds Series 1999 E1, with interest at 2.00% at June 30, 2005 and until November 1, 2006 and at 3.00% thereafter	3,000,000	3,100,000
Pennsylvania Higher Education Facilities Authority Revenue Bonds Series 2001 I2, with interest at 3.30% at June 30, 2005 and until November 1, 2006 and at 3.00% thereafter.	5,500,000	5,500,000
College Revenue Bonds of 2003, with interest at 3.25% at June 30, 2005 and until November 1, 2006 and at 3.00% thereafter	5,325,000	5,475,000
College Revenue Refunding Bonds Series A and B of 2004, with interest rates ranging from 2.20% to 5.00%	17,485,000	—
Total bonds payable	33,690,000	34,470,000
Total long-term debt	\$ 35,821,066	\$ 35,846,748

The College currently has two line-of-credit arrangements with two local banks that provide the College up to a total of \$2,700,000 for physical plant improvement projects and working capital.

The first agreement is for capital expenditures and expires on December 29, 2005. The original amount of the note was \$1,000,000, and was amended to \$1,700,000 on March 10, 2005. This note replaced the \$2,000,000 line-of-credit, which expired on June 30, 2004. The note accrues interest on outstanding borrowings at a rate equal to the (i) bank's prime lending rate minus .5%, or (ii) a LIBOR-Rate plus 1.50% for the applicable LIBOR-Rate Interest Period. Borrowings are secured by the gross revenues of the College, on parity with the Borrower's bondholders. The second

**Mercyhurst College**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

agreement is for capital expenditures and working capital up to \$1,000,000 and expires March 1, 2006. The note accrues interest on outstanding borrowings at a rate equal to the J.P. Morgan Chase Bank of New York City published prime lending rate minus .75%. A commitment fee of .05% is also assessed on any unused portion of the line-of-credit. Borrowings on the second line are unsecured and are a general obligation of the College. At June 30, 2005 and 2004 the balances outstanding under the lines-of-credit were \$1,999,921 and \$576,921 respectively.

On November 1, 2002, the College issued a \$1,950,000 installment note to the Glenwood Manor Apartment Charitable Remainder Annuity Trust (GMACRAT) in exchange for four apartment buildings currently used for student housing. The installment note requires 32 monthly installments of \$67,692 including interest at a rate of 7.8% per annum, which commenced on November 30, 2002 and ended on June 30, 2005. The note is secured by the four apartment buildings. Cash to make approximately 12 monthly installments to the GMACRAT was obtained in the 2003 Bond issue, and was held on deposit with a trustee. The balance of the principal and interest payments on the note were paid from the College's operating cash. The College is the charitable organization, as defined by the charitable remainder annuity trust agreement. Accordingly, upon termination of the GMACRAT, which is July 31, 2005, the trustees shall distribute the entire principal and income of the GMACRAT to the College. The principal and income remainder of the GMACRAT are not expected to be significant.

In October 1993, the College issued \$17,595,000 College Revenue Refunding Bonds, Series A of 1993, and \$6,120,000 College Revenue Refunding Bonds, Series B of 1993 (collectively, the 1993 Bonds) through the City of Erie Higher Education Authority (the Authority). The 1993 Bond proceeds were used to finance a project consisting of (a) advance refunding of all outstanding debt under previously issued Bonds; (b) the construction of on-campus apartment buildings, townhouses and a parking deck; (c) the purchase of certain land and buildings on which the College is situated; (d) a portion of the costs associated with the construction of a concert hall; (e) the funding of a debt service reserve fund; and (f) the financing of the costs relating to the issuance of the 1993 Bonds. In October of 2004, the College refinanced the 1993 Bonds, by issuing \$18,365,000 of College Revenue Refunding Bonds, Series A and Series B, as discussed further in this note.

On July 3, 1997, the College issued a \$3,920,000 bond issue through the Authority (the 1997 Bonds) for the purpose of (a) the acquisition of apartment buildings for student housing; (b) the completion and automation of the College's library; (c) the renovation of McAuley Hall; (d) the construction of additional College facilities; (e) the funding of a debt service reserve fund; and (f) the financing of all or a portion of the costs relating to the issuance of the 1997 Bonds.

On November 1, 1999, the College issued a \$3,500,000 bond issue through the Pennsylvania Higher Education Facilities Authority for the purpose of (a) purchase of four apartment buildings for student housing; (b) renovations to the Hammermill Library; (c) construction of eight townhouses for student housing located at 16 West Division Street at the campus located in the town of North East, Pennsylvania; (d) certain additional miscellaneous capital expenditures and (e) the payment of certain costs of issuing the bonds.

On November 1, 2001, the College issued a \$5,500,000 bond issue through the Pennsylvania Higher Education Facilities Authority for the purpose of (a) construction of the Audrey Hirt Academic Center and (b) the renovation of the College's hockey rink.

# Mercyhurst College

## Notes to Financial Statements

### June 30, 2005 and 2004

On July 31, 2003, the College issued a \$5,475,000 bond issue through the City of Erie Higher Education Building Authority (the Authority) for the purpose of (a) the acquisition of four apartment buildings on Lewis Avenue for student housing; (b) the acquisition of four apartment buildings known as “Highland Square” for student housing; (c) construction of two two-story residence halls on the College’s Erie campus; (d) construction of a two-story Health and Safety Building on the College’s North East campus; and (e) the payment of certain costs of issuing the bonds. On September 2, 2004, the College obtained approval from the Authority to amend the list of projects covered by the 2003 Bond Issue to include certain costs associated with the construction of a bookstore and the renovation of Old Main, both of which are located on the College’s Erie campus.

On October 1, 2004, the College issued \$13,225,000 College Revenue Refunding Bonds, Series A of 2004 and \$5,140,000 College Revenue Refunding Bonds, Series B of 2004 (collectively, the 2004 Bonds) through the Authority. The 2004 Bond proceeds were used to finance a project consisting of (a) advance refunding of all 1993 Bonds; and (b) the financing of the costs relating to the issuance of the 2004 Bonds.

The College is subject to certain financial and reporting covenants under the 1993, 1997, 1999, 2001, 2003, and 2004 Bond issues. The College is in compliance with these covenants, or has obtained written waivers for noncompliance.

As part of the 1993, 1997, and 2004 Bond issues, the Authority entered into a Sublease and Security Agreement, a Supplemental Sublease and Security Agreement, and a Second Supplemental Sublease and Security Agreement (the Agreements) with the College. Pursuant to the Agreements, the College is charged with operating and maintaining the related construction projects and making installment payments from its gross revenues in amounts sufficient to meet debt service requirements of the 1997 and 2004 Bonds.

The 1997 and 2004 Bonds are secured by all gross revenues of the College, subject to certain permitted encumbrances, and all existing and future equipment and fixtures of the College.

The 1999 Bonds are secured by a letter of credit with a bank in the amount of \$3,087,500. The letter of credit expires November 15, 2006 and is renewable thereafter.

The 2001 Bonds are secured by a letter of credit with a bank in the amount of \$5,660,417. The letter of credit expires November 15, 2006 and is renewable thereafter.

The 2003 Bonds are secured by a letter of credit with a bank in the amount of \$5,425,953. The letter of credit expires November 15, 2006 and is renewable thereafter.

The mandatory redemption and sinking fund requirements to redeem or otherwise retire principal amounts of the 1997, 1999 and 2001, 2003, and 2004 Bonds are as follows:

- *1997 Bonds* — Ranging from \$145,000 in 2006 to \$265,000 in 2017.
- *1999 Bonds* — Ranging from \$100,000 in 2006 to \$300,000 in 2020.
- *2001 Bonds* — Ranging from \$200,000 in 2006 to \$500,000 in 2022.

**Mercyhurst College**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

- *2003 Bonds* — Ranging from \$150,000 in 2006 to \$400,000 in 2024.
- *2004 Series A Bonds* – Ranging from \$780,000 in 2006 to \$1,150,000 in 2017, \$660,000 in 2018, \$695,000 in 2019, and \$80,000 in 2020 at maturity.
- *2004 Series B Bonds* – Ranging from \$195,000 in 2006 to \$345,000 in 2020, \$315,000 in 2021, \$330,000 in 2022, and \$340,000 in 2023 at maturity.

Aggregate annual maturities of long-term debt at June 30, 2005 are:

2006	\$ 3,701,066
2007	1,625,000
2008	1,785,000
2009	1,825,000
2010	1,965,000
Thereafter	<u>24,920,000</u>
	<u>\$ 35,821,066</u>

**Note 9: Net Assets**

Net assets are classified based on the existence or absence of donor-imposed restrictions.

***Temporarily Restricted Net Assets***

Temporarily restricted net assets at June 30 are available for the following purposes or future periods:

	<u>2005</u>	<u>2004</u>
Student services	\$ 22,279	\$ 21,319
Institutional support	1,041,486	879,337
Loan funds	510,034	510,034
Instruction	902,955	2,057,345
Academic support	10,994	9,883
Scholarships	1,890,147	709,098
Plant operations and additions	2,012,432	1,646,047
Public service	<u>29,920</u>	<u>24,412</u>
	<u>\$ 6,420,247</u>	<u>\$ 5,857,475</u>

**Mercyhurst College**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

***Permanently Restricted Net Assets***

Permanently restricted net assets at June 30 are restricted to investments in perpetuity, the income from which is expendable to support:

	<b>2005</b>	<b>2004</b>
Institutional support	\$ 1,067,842	\$ 1,016,285
Scholarships	7,548,391	7,180,962
Instructional	231,216	196,697
Public service	<u>62,209</u>	<u>62,209</u>
	<u>\$ 8,909,658</u>	<u>\$ 8,456,153</u>

***Net Assets Released from Restriction***

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors.

	<b>2005</b>	<b>2004</b>
Purpose of restrictions accomplished:		
Instructional activities	\$ 34,561	\$ 22,126
Academic support	1,812	101
Student services	7,841	9,391
Institutional support	6,166	48,125
Operation and maintenance of plant	—	64,473
Scholarships	<u>133,867</u>	<u>454,910</u>
	184,247	599,126
Plant fund expenditures	<u>456,811</u>	<u>22,148</u>
	<u>\$ 641,058</u>	<u>\$ 621,274</u>

**Note 10: Operating Leases**

The College has various operating lease agreements primarily involving facilities, office equipments and vehicles. These leases are noncancelable and expire on various dates through the year 2017.

**Mercyhurst College**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

Total rental expense for 2005 and 2004 was \$2,068,740 and \$1,656,384, respectively.

Future minimum lease payments at June 30 were:

2006		\$ 1,528,310
2007		1,202,336
2008		908,229
2009		609,948
2010		549,589
Thereafter		<u>2,421,725</u>
		<u>\$ 7,220,137</u>

**Note 11: Pension Plan**

Retirement benefits are provided for College employees through the Teachers Insurance and Annuity Association College Retirement Equities Fund (TIAA-CREF) a national organization, and the Variable Annuity Life Insurance Company (VALIC), used to fund pension benefits for educational institutions. Under the arrangement, the College and plan participants make monthly contributions to TIAA-CREF and VALIC to fund retirement benefits through an insured defined contribution plan. The plan covers substantially all eligible employees. The Colleges share of the cost of these benefits for the years ended June 30, 2005 and 2004 was \$894,083 and \$820,744, respectively.

**Note 12: Contingencies and Commitments**

The College is subject to claims and lawsuits that can arise primarily in the ordinary course of its activities. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits, if arisen, will not have a material adverse effect on the financial position, change in net assets and cash flows of the College.

The College is obligated to make certain payments to its former President who retired February 23, 2005. At the time of his retirement, the President was owed \$183,073 for deferred compensation and accrued earnings from fiscal years 1999 through his retirement, and \$86,607 for retirement benefits and accrued earnings from fiscal years 1993 through his retirement. In addition to these amounts, the College may be obligated to make certain other payments resulting from the President's final employment contract. While a final agreement has not been executed as of June 30, 2005, the College has estimated and accrued approximately \$616,000 for the settlement of this contract.

**Mercyhurst College**  
**Notes to Financial Statements**  
**June 30, 2005 and 2004**

**Note 13: Expense Summary**

Expenses classified by natural classification are summarized as follows:

	<u>2005</u>	<u>2004</u>
Salaries and wages	\$ 22,263,279	\$ 20,073,829
Fringe benefits	6,941,691	6,109,422
Contract services	2,612,415	2,076,827
Supplies	1,257,376	1,204,852
Travel	1,636,596	1,378,975
Repairs and maintenance	2,050,631	1,389,831
Utilities	1,982,198	1,759,000
Scholarships, externally funded	2,319,668	2,313,182
Cost of sales for auxiliary enterprises	4,564,317	4,178,102
Bad debts	334,992	218,750
Rents and leases	2,067,440	1,671,356
Non-capital equipment	860,690	849,607
Interest on indebtedness	1,254,278	1,607,519
Insurance	567,158	455,105
Depreciation and amortization	3,352,671	2,722,023
Bond call premium	357,600	—
Loss on disposition of assets	245,162	—
Other	<u>4,905,972</u>	<u>4,303,423</u>
	<u>\$ 59,574,134</u>	<u>\$ 52,311,803</u>

**Note 14: Functional Expenses**

The College's expenses on a functional basis are as follows:

	<u>2005</u>	<u>2004</u>
Instruction	\$ 20,434,611	\$ 18,829,627
Public service	246,866	222,193
Academic support	2,062,429	1,898,268
Student services	10,269,786	9,337,302
Institutional support	12,383,737	8,954,156
Scholarships and fellowships	2,319,668	2,313,182
Auxiliary enterprises	<u>11,857,037</u>	<u>10,757,075</u>
	<u>\$ 59,574,134</u>	<u>\$ 52,311,803</u>

## **Supplementary Information**

**Mercyhurst College**  
**Schedule of Expenditures of Federal Awards**  
**Year Ended June 30, 2005**

Federal Agency/ Pass-Through Entity/Cluster/Program	CFDA Number	Grant or Identifying Number	Amount
Department of Education			
Student Financial Aid Cluster			
Federal Work Study Program	84.033		\$ 383,308
Federal Pell Grant Program	84.063		2,437,926
Federal Supplemental Education Opportunity Grant	84.007		494,913
Federal Perkins Loan Program	84.038		3,233,997
Federal Family Education Loan Program	84.032		<u>19,337,951</u>
			25,888,095
<i>Pass-through from Pennsylvania Department of Education</i>			
Vocational Education Program	84.048	23-600-3115	113,063
PT3 Prep Tomorrow's Teachers for Technology	84.342A	23-600-3115	66,628
Project Teach	84.215X	03-992-8544	23,027
Intelligence Research and Analysis	84.116Z		172,745
Regional Health and Public Safety Building	84.116Z		<u>200,000</u>
Total Department of Education			<u>26,463,558</u>
Department of Labor			
<i>Pass-through from Pennsylvania Department of Labor</i>			
Trade Adjustment Act Program	17.245	23-600-3107	447,471
Pre-Teaching Academy TANF Challenge Grant	17.000	25-129-3830	<u>11,337</u>
Total Department of Labor			<u>458,808</u>
Department of Justice			
<i>Pass-through from Pennsylvania Commission on Crime and Delinquency</i>			
PCCD-Institute for Child and Family Policy (County of Erie)	16.523	25-600-1027	13,013
Drug Control and Systems Improvement (County of Erie)	16.579	25-600-0857	108,993
RIAP/University of Arkansas Terrorism	16.560	71-600-3252	64,092
RIAP/LFMSC Case Studies	16.000		21,367
Protective Services Institute			<u>25,183</u>
Total Department of Justice			<u>232,648</u>
Department of Health and Human Services			
<i>Pass through from Pennsylvania Department of Public Welfare</i>			
Child Care Development Block Grant	93.575	25-600-1265	2,281
NE Health Care Facilities and Other Construction	93.887		369,864
Start SMART Foundation	93.959		<u>8,141</u>
Total Department of Health and Human Services			<u>380,286</u>
Department of Defense			
MAI/Excavations at Rockshelters	12.421		480,651
National Security Administration	12.0663		56,407
Structural Analysis	12.		10,253
Integrated Roadmap	12.		52,620
Galileo Study	12.		3,784
Intergovernmental Personnel Act Mobility Program	27.011		<u>72,923</u>
Total Department of Defense			<u>676,638</u>
Total			<u>\$ 28,211,938</u>

**Mercyhurst College**  
**Schedule of Expenditures and Federal Awards**  
**Year Ended June 30, 2005**

**Notes to Schedule**

1. This schedule includes the federal awards activity of Mercyhurst College and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.
2. Mercyhurst College provided no federal awards to subrecipients.
3. The FFEL Program consists of subsidized and unsubsidized Federal Stafford Loans (for students), Federal PLUS Loans (for parents) and FFEL Consolidation Loans (for both students and parents). Participating lending institutions, such as banks and credit unions, make these loans, which are guaranteed by state or national guaranty agencies and insured by the federal government. Federal statute requires that proceeds from Stafford Loans and PLUS Loans be disbursed to the College to be directly applied to students' accounts. New loans processed for students during the year ended June 30, 2005 were as follows:

Federal Family Education Loan Program	
Stafford	
Subsidized	\$ 8,764,889
Unsubsidized	6,383,252
PLUS	<u>4,189,810</u>
	<u>\$ 19,337,951</u>



## **Independent Accountants' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards***

Board of Trustees  
Mercyhurst College  
Erie, Pennsylvania

We have audited the financial statements of Mercyhurst College as of and for the year ended June 30, 2005, and have issued our report thereon dated September 2, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### **Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the College's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the College's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to the College's management in a separate letter dated September 2, 2005.

This report is intended solely for the information and use of the governing body, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*BKD, LLP*

September 2, 2005



## **Independent Accountants' Report on Compliance and Internal Control Over Compliance with Requirements Applicable to Major Federal Awards Programs**

Board of Trustees  
Mercyhurst College  
Erie, Pennsylvania

### **Compliance**

We have audited the compliance of Mercyhurst College with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2005. The College's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the College's management. Our responsibility is to express an opinion on the compliance of Mercyhurst College based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the College's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the College's compliance with those requirements.

In our opinion, Mercyhurst College complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2005.

### **Internal Control Over Compliance**

The management of Mercyhurst College is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the College's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the governing body, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*BKD, LLP*

September 2, 2005

**Mercyhurst College**  
**Schedule of Findings and Questioned Costs**  
**Year Ended June 30, 2005**

**Summary of Auditor's Results**

1. The opinion expressed in the independent accountants' report was:  
 Unqualified       Qualified       Adverse       Disclaimed
  
2. The independent accountants' report on internal control over financial reporting described:  
Reportable condition(s) noted considered material weakness(es)?       Yes       No  
Reportable condition(s) noted that are not considered to be a material weakness?       Yes       No
  
3. Noncompliance considered material to the financial statements was disclosed by the audit?       Yes       No
  
4. The independent accountants' report on internal control over compliance with requirements applicable to major federal awards programs described:  
Reportable condition(s) noted considered material weakness(es)?       Yes       No  
Reportable condition(s) noted that are not considered to be a material weakness?       Yes       No
  
5. The opinion expressed in the independent accountants' report on compliance with requirements applicable to major federal awards was:  
 Unqualified       Qualified       Adverse       Disclaimed
  
6. The audit disclosed findings required to be reported by OMB Circular A-133?       Yes       No

**Mercyhurst College**  
**Schedule of Findings and Questioned Costs**  
**Year Ended June 30, 2005**

7. The Organization's major programs were:

Cluster/Program	CFDA Number
Student Financial Aid Cluster	84.063, 84.007, 84.033, 84.032, 84.038

8. The threshold used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133 was \$846,358.

9. The Organization qualified as a low-risk auditee as that term is defined in OMB Circular A-133?  Yes  No

**Mercyhurst College**  
**Schedule of Findings and Questioned Costs**  
**Year Ended June 30, 2005**

**Findings Required to be Reported by *Government Auditing Standards***

<b>Reference Number</b>	<b>Finding</b>	<b>Questioned Costs</b>
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No matters are reportable.

**Findings Required to be Reported by OMB Circular A-133**

<b>Reference Number</b>	<b>Finding</b>	<b>Questioned Costs</b>
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No matters are reportable.

**Mercyhurst College**  
**Summary Schedule of Prior Audit Findings**  
**Year Ended June 30, 2005**

<b>Reference Number</b>	<b>Summary of Finding</b>	<b>Status</b>
	No matters are reportable.	