

Mercyhurst College

Accountants' Report and Financial Statements

June 30, 2008 and 2007



Mercyhurst College
June 30, 2008 and 2007

Contents

**Independent Accountants' Report on Financial Statements and
Supplementary Information 1**

Financial Statements

 Statements of Financial Position 2

 Statements of Activities..... 3

 Statements of Cash Flows 5

 Notes to Financial Statements 6

Supplementary Information

 Schedule of Expenditures of Federal Awards 20

**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 22**

**Independent Accountants' Report on Compliance and Internal Control
Over Compliance with Requirements Applicable to Major Federal
Awards Programs 24**

Schedule of Findings and Questioned Costs..... 26

Summary Schedule of Prior Audit Findings 29



Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Trustees
Mercyhurst College
Erie, Pennsylvania

We have audited the accompanying statements of financial position of Mercyhurst College as of June 30, 2008 and 2007 and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Mercyhurst College as of June 30, 2008 and 2007, and the changes in its net assets and its cash flows for the years 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 October 7, 2008, on our consideration of the Organization'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 audits were conducted for the purpose of forming an opinion on the 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 audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

BKD, LLP

October 7, 2008

Mercyhurst College
Statements of Financial Position
June 30, 2008 and 2007

Assets

	2008	2007
Cash and cash equivalents	\$ 9,618,682	\$ 10,039,343
Accounts receivable, net of allowance; 2008 - \$930,023, 2007 - \$470,145	2,467,982	1,776,275
Contributions receivable, net	3,183,002	187,000
Receivable from charitable remainder trust	526,490	647,667
Loans receivable, net of allowance; 2008 - \$118,677, 2007 - \$139,270	2,797,782	2,631,217
Inventories	413,866	379,169
Prepaid expenses and other assets	360,274	392,615
Bond discount and issuance costs, net	752,241	298,246
Deposits with trustees	19,326,227	2,029,960
Long-term investments	22,347,296	24,185,079
Land, buildings and equipment, net	74,350,114	70,520,379
Total assets	\$ 136,143,956	\$ 113,086,950

Liabilities and Net Assets

Liabilities

Accounts payable	\$ 1,435,734	\$ 1,594,533
Accrued expenses and other liabilities	2,645,807	2,311,811
Accrued interest	517,572	358,491
Student deposits	1,905,270	1,456,905
Deferred revenue	1,239,762	1,032,739
Notes payable and capital leases	1,699,116	1,707,291
Bonds payable	48,755,000	30,495,000
Advances from Federal government for student loans	2,243,610	2,244,764
Trusts payable	291,695	285,374
Total liabilities	60,733,566	41,486,908

Net Assets

Unrestricted	58,641,306	54,256,070
Temporarily restricted	4,648,938	6,438,541
Permanently restricted	12,120,146	10,905,431
Total net assets	75,410,390	71,600,042
Total liabilities and net assets	\$ 136,143,956	\$ 113,086,950

Mercyhurst College
Statement of Activities
Year Ended June 30, 2008

	2008			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Revenues, Gains and Other Support				
Tuition and fees	\$ 75,435,712	\$ —	\$ —	\$ 75,435,712
Less college funded financial aid and scholarships	<u>29,751,357</u>	<u>—</u>	<u>—</u>	<u>29,751,357</u>
Net tuition and fees	45,684,355	—	—	45,684,355
Government grants and other contracts	6,011,387	—	—	6,011,387
Private gifts	3,606,221	540,680	1,213,715	5,360,616
Investment income	808,916	691,948	—	1,500,864
Net realized and unrealized losses	(998,263)	(1,773,245)	—	(2,771,508)
Other revenues	1,296,321	—	—	1,296,321
Auxiliary enterprises	17,396,458	—	—	17,396,458
Change in value of split interest agreements	—	(127,499)	—	(127,499)
Net assets released from restrictions	1,027,101	(1,027,101)	—	—
Reclassification of net assets	<u>93,386</u>	<u>(94,386)</u>	<u>1,000</u>	<u>—</u>
Total revenues, gains and other support	<u>74,925,882</u>	<u>(1,789,603)</u>	<u>1,214,715</u>	<u>74,350,994</u>
Expenses and Other Deductions				
Instruction	26,860,212	—	—	26,860,212
Public service	279,655	—	—	279,655
Academic support	2,536,379	—	—	2,536,379
Student services	13,240,805	—	—	13,240,805
Institutional support	12,546,020	—	—	12,546,020
Auxiliary enterprises	13,635,236	—	—	13,635,236
Interest	<u>1,442,339</u>	<u>—</u>	<u>—</u>	<u>1,442,339</u>
Total expenses and other deductions	<u>70,540,646</u>	<u>—</u>	<u>—</u>	<u>70,540,646</u>
Change in Net Assets	4,385,236	(1,789,603)	1,214,715	3,810,348
Net Assets, Beginning of Year	<u>54,256,070</u>	<u>6,438,541</u>	<u>10,905,431</u>	<u>71,600,042</u>
Net Assets, End of Year	<u>\$ 58,641,306</u>	<u>\$ 4,648,938</u>	<u>\$ 12,120,146</u>	<u>\$ 75,410,390</u>

Mercyhurst College
Statement of Activities
Year Ended June 30, 2007

	2007			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Revenues, Gains and Other Support				
Tuition and fees	\$ 69,311,746	\$ —	\$ —	\$ 69,311,746
Less college funded financial aid and scholarships	<u>26,955,054</u>	<u>—</u>	<u>—</u>	<u>26,955,054</u>
Net tuition and fees	42,356,692	—	—	42,356,692
Government grants and other contracts	6,069,868	—	—	6,069,868
Private gifts	702,085	284,753	1,662,174	2,649,012
Investment income	817,137	433,575	—	1,250,712
Net realized and unrealized gains	1,117,031	1,907,674	—	3,024,705
Other revenues	1,225,285	—	—	1,225,285
Auxiliary enterprises	16,812,625	—	—	16,812,625
Change in value of split interest agreements	—	82,421	—	82,421
Net assets released from restrictions	1,250,879	(1,250,879)	—	—
Reclassification of net assets	<u>173,359</u>	<u>71,641</u>	<u>(245,000)</u>	<u>—</u>
Total revenues, gains and other support	<u>70,524,961</u>	<u>1,529,185</u>	<u>1,417,174</u>	<u>73,471,320</u>
Expenses and Other Deductions				
Instruction	24,720,386	—	—	24,720,386
Public service	280,293	—	—	280,293
Academic support	2,488,288	—	—	2,488,288
Student services	11,999,602	—	—	11,999,602
Institutional support	10,340,719	—	—	10,340,719
Auxiliary enterprises	12,759,470	—	—	12,759,470
Interest	<u>1,404,563</u>	<u>—</u>	<u>—</u>	<u>1,404,563</u>
Total expenses and other deductions	<u>63,993,321</u>	<u>—</u>	<u>—</u>	<u>63,993,321</u>
Change in Net Assets	6,531,640	1,529,185	1,417,174	9,477,999
Net Assets, Beginning of Year	<u>47,724,430</u>	<u>4,909,356</u>	<u>9,488,257</u>	<u>62,122,043</u>
Net Assets, End of Year	<u>\$ 54,256,070</u>	<u>\$ 6,438,541</u>	<u>\$ 10,905,431</u>	<u>\$ 71,600,042</u>

Mercyhurst College
Statements of Cash Flows
Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Operating Activities		
Change in net assets	\$ 3,810,348	\$ 9,477,999
Items not requiring (providing) operating activities cash flows		
Depreciation and amortization	3,838,134	3,393,147
Net realized and unrealized (gains) losses on investments	2,771,508	(3,024,705)
Change in value of split interest agreements	127,499	(82,421)
Contributions received restricted for long-term investment	(1,213,715)	(1,662,174)
Changes in		
Receivables	(3,854,275)	(201,001)
Inventories	(34,696)	23,810
Prepaid expenses and other assets	32,341	73,191
Accounts payable	(158,799)	(52,382)
Accrued expenses and other liabilities	493,077	114,494
Student deposits	448,365	8,938
Deferred revenue	207,023	(159,694)
Advances from Federal government for student loans	<u>(1,154)</u>	<u>(13,517)</u>
Net cash provided by operating activities	<u>6,465,656</u>	<u>7,895,685</u>
Investing Activities		
Purchase of land, buildings and equipment	(7,604,857)	(4,057,186)
Purchase of long-term investments	(4,462,725)	(27,853,160)
Proceeds from disposition of long-term investments	3,529,000	24,000,838
Change in deposits with trustees	<u>(17,296,267)</u>	<u>221,441</u>
Net cash used in investing activities	<u>(25,834,849)</u>	<u>(7,688,067)</u>
Financing Activities		
Principal borrowings on bonds	21,970,000	—
Principal payments on bonds	(3,710,000)	(1,775,000)
Principal borrowings on notes payable	903,017	1,162,000
Principal payments on notes payable	(911,192)	(971,297)
Payments for bond issuance costs	(517,008)	—
Proceeds from contributions restricted for long-term investment	<u>1,213,715</u>	<u>1,662,174</u>
Net cash provided by financing activities	<u>18,948,532</u>	<u>77,877</u>
(Decrease) Increase in Cash and Cash Equivalents	(420,661)	285,495
Cash and Cash Equivalents, Beginning of Year	<u>10,039,343</u>	<u>9,753,848</u>
Cash and Cash Equivalents, End of Year	<u>\$ 9,618,682</u>	<u>\$ 10,039,343</u>
Supplemental Cash Flows Information		
Interest paid	\$ 1,283,258	\$ 1,394,208

Mercyhurst College
Notes to Financial Statements
June 30, 2008 and 2007

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, 2008 and 2007, cash equivalents consisted primarily of money market funds. At June 30, 2008, the College's cash accounts exceeded federally insured limits by approximately \$10,007,000.

Fair Value of Financial Instruments

The College's financial instruments which include cash, cash equivalents, receivables, investments, accounts payable, accrued expenses, other liabilities 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 investment income, which includes interest and dividends; 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, 2008 and 2007

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 the fall term, and one to two weeks prior to the first day of the winter and spring terms. 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, 2008 and 2007

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 expends funds 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, 2008 and 2007

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 income.

Reclassifications

The College identified certain net asset fund balances that had been misclassified between unrestricted, temporarily restricted and permanently restricted during 2008 and 2007. The following net assets were reclassified in the 2008 and 2007 financial statements to appropriately recognize the restricted nature of certain net asset fund balances:

	2008	2007
Unrestricted	\$ 93,386	\$ 173,359
Temporarily restricted	(94,386)	71,641
Permanently restricted	1,000	(245,000)

The reclassifications had no effect on changes in net assets for 2008 and 2007.

Note 2: Investments

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

	2008	2007
Cash equivalents	\$ 17,995,544	\$ 150,672
U.S. Treasury securities	1,466,138	2,022,884
Collective fixed income funds	3,711,988	3,784,670
Collective equity funds	12,071,803	14,064,354
Equity securities	3,142,759	3,696,421
Hedge fund-of-funds	2,863,123	2,073,870
Real estate	422,168	422,168
	<u>\$ 41,673,523</u>	<u>\$ 26,215,039</u>

Mercyhurst College
Notes to Financial Statements
June 30, 2008 and 2007

Note 3: Contributions Receivable and Conditional Gifts

Contributions receivable consisted of the following:

	June 30, 2008			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Due within one year	\$ 878,641	\$ 41,177	\$ 367,108	\$ 1,286,926
Due in one to five years	<u>1,604,048</u>	<u>4,667</u>	<u>744,667</u>	<u>2,353,382</u>
	2,482,689	45,844	1,111,775	3,640,308
Less				
Allowance for uncollectible contributions	(37,510)	(693)	(16,797)	(55,000)
Unamortized discount	<u>(277,499)</u>	<u>(2,934)</u>	<u>(121,873)</u>	<u>(402,306)</u>
	<u>\$ 2,167,680</u>	<u>\$ 42,217</u>	<u>\$ 973,105</u>	<u>\$ 3,183,002</u>

	June 30, 2007			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Due within one year	\$ 50,025	\$ 54,395	\$ 8,109	\$ 112,529
Due in one to five years	<u>150,000</u>	<u>10,792</u>	<u>—</u>	<u>160,792</u>
	200,025	65,187	8,109	273,321
Less				
Allowance for uncollectible contributions	(40,050)	(13,052)	(1,624)	(54,726)
Unamortized discount	<u>(26,750)</u>	<u>(4,387)</u>	<u>(458)</u>	<u>(31,595)</u>
	<u>\$ 133,225</u>	<u>\$ 47,748</u>	<u>\$ 6,027</u>	<u>\$ 187,000</u>

The discount rate used was 6% for 2008 and 2007.

Mercyhurst College
Notes to Financial Statements
June 30, 2008 and 2007

The College has been named in will commitments totaling \$1,605,000 at June 30, 2008 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, 2008 and 2007, the College's beneficial interest in the remainder trust administered by an outside party is \$526,490 and \$647,667, respectively.

Note 5: Land, Buildings, and Equipment

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

	2008	2007
Land	\$ 3,826,217	\$ 3,375,134
Land improvements	8,327,257	8,275,671
Buildings	76,132,987	72,715,383
Furnishings and equipment	20,814,666	19,550,814
Library books	4,349,359	4,155,148
Construction-in-progress	<u>2,719,674</u>	<u>524,903</u>
	116,170,160	108,597,053
Less: accumulated depreciation	<u>41,820,046</u>	<u>38,076,674</u>
	<u>\$ 74,350,114</u>	<u>\$ 70,520,379</u>

Note 6: Accrued Expenses and Other Liabilities

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

	2008	2007
Accrued payroll and deferred compensation	\$ 1,652,722	\$ 1,545,141
Accrued payroll taxes and withholdings	259,198	128,335
Accrued vacation	541,460	496,916
Other accrued expenses	<u>192,427</u>	<u>141,419</u>
	<u>\$ 2,645,807</u>	<u>\$ 2,311,811</u>

Mercyhurst College
Notes to Financial Statements
June 30, 2008 and 2007

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.

Note 8: Long-term Debt

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

	2008	2007
Notes payable		
Lines of Credit	\$ 1,528,050	\$ 1,698,958
Other	<u>—</u>	<u>8,333</u>
Total notes payable	<u>1,528,050</u>	<u>1,707,291</u>
 Capital Lease obligations		
Capital lease obligation includes a ten year lease covering washer and dryer equipment used in the College's dormitories and housing facilities. The lease expires in the year 2017.	<u>171,066</u>	<u>—</u>
 Bonds payable		
College Revenue Bonds of 1997, with interest rates ranging from 5.45% to 5.85%	—	2,085,000
Pennsylvania Higher Education Facilities Authority Revenue Bonds Series 1999 E1, with interest at 1.55% at June 30, 2008 and at variable rates thereafter that are based upon the Bond Market Association (BMA) index.	2,600,000	2,800,000
Pennsylvania Higher Education Facilities Authority Revenue Bonds Series 2001 I2, with interest at 1.55% at June 30, 2008 and at variable rates thereafter that are based upon the BMA index.	4,900,000	5,100,000
College Revenue Bonds of 2003, with interest at a swap rate of 3.82% at June 30, 2008 until November 1, 2012, and at variable rates thereafter that are based upon the BMA index.	4,800,000	5,000,000
College Revenue Refunding Bonds Series A and B of 2004, with interest rates ranging from 3.50% to 5.00%	14,485,000	15,510,000
College Revenue Bonds of 2008, with interest rates ranging from 4.00% to 5.50%	<u>21,970,000</u>	<u>—</u>
Total bonds payable	<u>48,755,000</u>	<u>30,495,000</u>
Total long-term debt	<u>\$ 50,454,116</u>	<u>\$ 32,202,291</u>

Mercyhurst College
Notes to Financial Statements
June 30, 2008 and 2007

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 31, 2009. The original amount of the note was \$1,000,000, and was amended to \$1,700,000 on March 10, 2005. 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. On March 23, 2006, the College entered into a one year \$1,000,000 revolving line of credit for short term working capital with a bank to replace a line of credit with another bank which expired March 1, 2006. Borrowings on the line are unsecured and are a general obligation of the College. The line of credit expires March 22, 2010. The note accrues interest on outstanding borrowings at a rate equal to the LIBOR-flex rate plus 1.25%. A commitment fee of 0.125% is assessed on any unused portion of the line of credit. At June 30, 2008 and 2007 the balances outstanding under the lines of credit were \$1,528,050 and \$1,698,958 respectively.

On July 3, 1997, the College issued a \$3,920,000 bond issue through the City of Erie Higher Education Building Authority (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 June 1, 2008, the College refinanced the remaining outstanding principal of the 1997 Bonds on a current refunding basis, by issuing \$1,925,000 as part of the 2008 Bond issue.

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.

On July 31, 2003, the College issued a \$5,475,000 bond issue through 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.

Mercyhurst College
Notes to Financial Statements
June 30, 2008 and 2007

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) current refunding of all 1993 Bonds; and (b) the financing of the costs relating to the issuance of the 2004 Bonds. 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.

On June 1, 2008, the College issued \$21,970,000 College Revenue Bonds through the Authority. The 2008 Bond proceeds were used to finance a project consisting of (a) current refunding of all 1997 Bonds, (b) the financing of the construction of a four-story, approximately 100,000 square foot 320-bed residence hall on the College's Erie campus, (c) the financing of the construction of a two-story, approximately 22,000 square foot 75-bed residence hall on the College's North East campus, (d) the funding of a debt service reserve fund; and (e) the financing of the costs relating to the issuance of the 2008 Bonds.

The College is subject to certain financial and reporting covenants under the 1999, 2001, 2003, 2004, and 2008 Bond issues. The College is in compliance with these covenants.

As part of the 1993, 1997, 2004, and 2008 Bond issues, the Authority entered into a Sublease and Security Agreement, a Supplemental Sublease and Security Agreement, a Second Supplemental Sublease and Security Agreement, and a Third 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 2004 and 2008 Bonds.

The 2004 and 2008 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 \$2,647,667. The letter of credit expires July 1, 2012 and is renewable thereafter.

The 2001 Bonds are secured by a letter of credit with a bank in the amount of \$4,989,833. The letter of credit expires July 1, 2012 and is renewable thereafter.

The 2003 Bonds are secured by a letter of credit with a bank in the amount of \$4,889,600. The letter of credit expires July 1, 2012 and is renewable thereafter.

Mercyhurst College
Notes to Financial Statements
June 30, 2008 and 2007

The mandatory redemption and sinking fund requirements to redeem or otherwise retire principal amounts of the 1999 and 2001, 2003, 2004, and 2008 Bonds are as follows:

- *1999 Bonds* — Ranging from \$200,000 in 2009 to \$300,000 in 2020 at maturity.
- *2001 Bonds* — Ranging from \$200,000 in 2009 to \$500,000 in 2022 at maturity.
- *2003 Bonds* — Ranging from \$200,000 in 2009 to \$400,000 in 2024 at maturity.
- *2004 Series A Bonds* – Ranging from \$840,000 in 2009 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 \$215,000 in 2009 to \$345,000 in 2020, \$315,000 in 2021, \$330,000 in 2022, and \$340,000 in 2023 at maturity.
- *2008 Bonds* – Ranging from \$405,000 in 2012 to \$1,480,000 in 2038 at maturity.

Aggregate annual maturities and sinking fund requirements of long-term debt and payments on capital lease obligations at June 30, 2008:

	Long-term debt (excluding leases)	Capital Lease Obligations
2009	\$ 1,655,000	\$ 35,820
2010	3,313,050	35,820
2011	1,820,000	35,820
2012	2,280,000	35,820
2013	2,440,000	35,820
Thereafter	<u>38,775,000</u>	<u>149,250</u>
	<u>\$ 50,283,050</u>	328,350
Less amount representing interest		<u>157,284</u>
Payments		<u>\$ 171,066</u>

Note 9: Derivative Financial Instruments

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations, the College entered into an interest rate swap agreement for a portion of its floating rate debt. The agreement provides for the College to receive interest from the counterparty at 67% of LIBOR and to pay interest to the counterparty at a fixed rate of 3.82% on a notional amount of \$4,800,000 at June 30, 2008. Under the agreement, the College pays or receives the net interest amount monthly, with the monthly settlements included in interest expense. The agreement is recorded at its fair value with subsequent changes in fair value included in expenses and other deductions.

Mercyhurst College
Notes to Financial Statements
June 30, 2008 and 2007

Note 10: 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>2008</u>	<u>2007</u>
Student services	\$ 79,219	\$ 40,360
Institutional support	949,623	1,482,272
Loan funds	43,696	37,762
Instruction	1,553,452	2,157,501
Academic support	3,324	3,182
Scholarships	1,265,849	2,251,176
Plant operations and additions	721,716	427,404
Public service	<u>32,059</u>	<u>38,884</u>
	<u>\$ 4,648,938</u>	<u>\$ 6,438,541</u>

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:

	<u>2008</u>	<u>2007</u>
Institutional support	\$ 2,412,237	\$ 2,410,003
Scholarships	8,340,952	8,317,961
Instructional	1,304,748	115,258
Public service	<u>62,209</u>	<u>62,209</u>
	<u>\$ 12,120,146</u>	<u>\$ 10,905,431</u>

Mercyhurst College
Notes to Financial Statements
June 30, 2008 and 2007

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.

	<u>2008</u>	<u>2007</u>
Purpose of restrictions accomplished:		
Instructional activities	\$ 28,395	\$ 42,520
Academic support	777	2,817
Institutional support	271,611	193,625
Operation and maintenance of plant	40,629	89,503
Scholarships	<u>685,689</u>	<u>814,957</u>
	1,027,101	1,143,422
Plant fund expenditures	<u>—</u>	<u>107,457</u>
	<u>\$ 1,027,101</u>	<u>\$ 1,250,879</u>

Note 11: Operating Leases

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

Total rental expense for 2008 and 2007 was \$2,034,429 and \$2,077,332, respectively.

Future minimum lease payments at June 30 were:

2009	\$ 1,592,347
2010	1,168,316
2011	778,143
2012	546,944
2013	471,526
Thereafter	<u>1,157,855</u>
	<u>\$ 5,715,131</u>

Mercyhurst College
Notes to Financial Statements
June 30, 2008 and 2007

Note 12: 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 a defined contribution plan. The plan covers a majority of all eligible employees. The College's share of the cost of these benefits for the years ended June 30, 2008 and 2007 was \$1,119,462 and \$1,054,475, respectively.

Note 13: 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 they were to occur, will not have a material adverse effect on the financial position, change in net assets and cash flows of the College.

Note 14: Expense Summary

Expenses classified by natural classification are summarized as follows:

	<u>2008</u>	<u>2007</u>
Salaries and wages	\$ 26,892,008	\$ 24,968,340
Fringe benefits	9,164,634	7,871,380
Contract services	3,225,117	3,050,793
Supplies	1,462,736	1,440,569
Travel	2,233,968	1,796,574
Repairs and maintenance	1,958,531	1,665,597
Utilities	2,272,927	2,145,587
Cost of sales for auxiliary enterprises	5,098,357	4,894,734
Bad debts	968,750	366,708
Rents and leases	2,034,429	2,077,332
Non-capital equipment	1,671,556	1,081,520
Interest on indebtedness	1,448,109	1,404,563
Insurance	810,656	775,814
Depreciation and amortization	3,838,134	3,393,147
Other	<u>7,460,734</u>	<u>7,060,663</u>
	<u>\$ 70,540,646</u>	<u>\$ 63,993,321</u>

Mercyhurst College
Notes to Financial Statements
June 30, 2008 and 2007

Note 15: Functional Expenses

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

	<u>2008</u>	<u>2007</u>
Instruction	\$ 28,310,376	\$ 26,085,500
Public service	279,655	280,293
Academic support	2,540,194	2,488,288
Student services	13,231,503	11,939,288
Institutional support	11,523,973	9,421,761
Auxiliary enterprises	13,635,236	12,759,470
Fundraising	<u>1,019,709</u>	<u>1,018,721</u>
	<u>\$ 70,540,646</u>	<u>\$ 63,993,321</u>

Supplementary Information

Mercyhurst College
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2008

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		\$ 421,733
Federal Pell Grant Program	84.063		3,430,248
Federal Supplemental Education Opportunity Grant	84.007		566,693
Federal Perkins Loan Program	84.038		3,437,375
Federal Family Education Loan Program	84.032		23,509,873
Academic Competitiveness Grant	84.375		109,925
National Science and Mathematics Access to Retain Talent Grant	84.376		58,667
<i>Pass-through from Pennsylvania Department of Education</i>			
Vocational Education Program	84.048	23-600-3115	198,214
Project Teach	84.215X	03-992-8544	13,522
ACH Program	84.215X	25-600-1265	24,631
Art-Based Teacher ED	84.116Z		<u>37,727</u>
Total Department of Education			<u>31,808,608</u>
Department of Labor			
<i>Pass-through from Pennsylvania Department of Labor</i>			
Trade Adjustment Act Program	17.245	23-600-3107	<u>146,375</u>
Total Department of Labor			<u>146,375</u>
Department of Justice			
<i>Pass-through from Pennsylvania Commission on Crime and Delinquency</i>			
Knife and Saw Tool Mark Analysis	16.	2005-IJ-CX-K016	<u>41,361</u>
Total Department of Justice			<u>41,361</u>
Department of Health and Human Services			
<i>Pass-through from Pennsylvania Department of Public Welfare</i>			
Temporary Assistance for Needy Families – TANF Challenge	93.558	25-129-3830	<u>725</u>
Total Department of Health and Human Services			<u>725</u>
Department of Defense			
National Security Administration	12.	H98230-05-D0101	267,897
HHS ID Dev	12.	SDSASD07CA002	<u>408,708</u>
Total Department of Defense			<u>676,605</u>
Department of Commerce			
Coastal Zone Management Implementation	11.419	7C-K-460	17,256
NOAA Eastern Gulf of Mexico	11.460		<u>180</u>
Total Department of Commerce			<u>17,436</u>
Office of National Drug Control Policy			
Washington DC/Baltimore HIDTA Project		17PWBP800ZZ920601	<u>120,818</u>
Total Office of National Drug Control Policy			<u>120,818</u>
Environmental Protection Agency			
Great Lakes Program – LERC Conneaut Creek Watershed	66.469		<u>9,744</u>
Total Environmental Protection Agency			<u>9,744</u>
Total			<u>\$ 32,821,672</u>

Mercyhurst College
Schedule of Expenditures and Federal Awards
Year Ended June 30, 2008

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 graduate students) and FFEL Consolidation Loans (for both students and parents) and Federal Perkins (for students). 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, 2008 were as follows:

Federal Family Education Loan Program	
Stafford	
Subsidized	\$ 10,528,570
Unsubsidized	7,677,749
PLUS	4,782,312
Perkins	<u>521,242</u>
	<u>\$ 23,509,873</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, 2008, and have issued our report thereon dated October 7, 2008. 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 Organization's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the Organization's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Organization's financial statements that is more than inconsequential will not be prevented or detected by the Organization's internal control.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Organization's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Organization'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 additional matters that we reported to the Organization's management in a separate letter dated October 7, 2008.

This report is intended solely for the information and use of the governing body, management and others within the Organization 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

October 7, 2008



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, 2008. The Organization'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 Organization'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 Organization'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 Organization'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, 2008.

Internal Control Over Compliance

The management of Mercyhurst College is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Organization's internal control over compliance with the 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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over compliance.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

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

October 7, 2008

Mercyhurst College
Schedule of Findings and Questioned Costs
Year Ended June 30, 2008

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:
Significant deficiency(ies) noted considered material weakness(es)? Yes No
Significant deficiency(ies) 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 (continued)
Year Ended June 30, 2008

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, 84.375, 84.376

8. The threshold used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133 was \$849,130.

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 (continued)
Year Ended June 30, 2008

Findings Required to be Reported by *Government Auditing Standards*

Reference Number	Finding	Questioned Costs
-----------------------------	----------------	-----------------------------

No matters are reportable.

Findings Required to be Reported by OMB Circular A-133

Reference Number	Finding	Questioned Costs
-----------------------------	----------------	-----------------------------

No matters are reportable.

Mercyhurst College
Summary Schedule of Prior Audit Findings
Year Ended June 30, 2008

Reference Number	Summary of Finding	Status
07-01	Special Tests and Provisions – Changes in student status for two students were not reported to NSLDS within 30 days or included in a response to a Roster File within 60 days.	Corrected