

Mercyhurst College

Accountants' Report and Financial Statements

May 31, 2011



Mercyhurst College
May 31, 2011

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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 (the College) as of May 31, 2011, and the related statements of activities and cash flows for the eleven-month period 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.

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 financial statements referred to above present fairly, in all material respects, the financial position of Mercyhurst College as of May 31, 2011, and the changes in its net assets and its cash flows for the eleven-month period 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 24, 2011, 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 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 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 24, 2011

Mercyhurst College
Statement of Financial Position
May 31, 2011

Assets

Cash and cash equivalents	\$ 15,889,011
Accounts receivable, net of allowance of \$764,241	3,775,944
Contributions receivable, net	2,126,023
Beneficial interest in charitable remainder trust	574,927
Loans receivable, net of allowance of \$118,677	2,564,708
Inventories	446,892
Prepaid expenses and other assets	431,214
Bond discount and issuance costs, net	557,884
Deposits with trustees	3,150,701
Long-term investments	26,531,649
Land, buildings and equipment, net	<u>91,113,978</u>
 Total assets	 <u>\$ 147,162,931</u>

Liabilities and Net Assets

Liabilities

Accounts payable	\$ 2,309,545
Accrued expenses and other liabilities	3,692,449
Accrued interest	594,153
Student deposits	1,676,769
Deferred revenue	232,338
Notes payable and capital leases	1,573,212
Bonds payable	43,495,000
Federal government advances for student loans	2,267,892
Trusts payable	<u>241,049</u>
 Total liabilities	 56,082,407

Net Assets

Unrestricted	69,502,403
Temporarily restricted	5,731,855
Permanently restricted	<u>15,846,266</u>
 Total net assets	 <u>91,080,524</u>
 Total liabilities and net assets	 <u>\$ 147,162,931</u>

See Notes to Financial Statements

Mercyhurst College
Statement of Activities
Eleven-Month Period Ended May 31, 2011

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenues, Gains and Other Support				
Tuition and fees	\$ 86,096,836	\$ -	\$ -	\$ 86,096,836
Less college funded financial aid and scholarships	<u>39,226,312</u>	<u>-</u>	<u>-</u>	<u>39,226,312</u>
Net tuition and fees	46,870,524	-	-	46,870,524
Government grants and other contracts	7,133,259	-	-	7,133,259
Private gifts	787,860	51,317	1,304,895	2,144,072
Appropriation of endowment investment return	422,461	807,743	-	1,230,204
Other investment return	1,170,820	422,475	-	1,593,295
Other revenues	1,872,494	-	-	1,872,494
Auxiliary enterprises	20,111,918	-	-	20,111,918
Change in value of split interest agreements	-	72,326	-	72,326
Net assets released from restrictions	<u>1,151,256</u>	<u>(1,151,256)</u>	<u>-</u>	<u>-</u>
Total revenues, gains and other support	<u>79,520,592</u>	<u>202,605</u>	<u>1,304,895</u>	<u>81,028,092</u>
Expenses and Other Deductions				
Instruction	30,610,687	-	-	30,610,687
Public service	219,549	-	-	219,549
Academic support	3,060,121	-	-	3,060,121
Student services	14,207,704	-	-	14,207,704
Institutional support	10,258,663	-	-	10,258,663
Auxiliary enterprises	14,275,895	-	-	14,275,895
Interest	<u>1,757,665</u>	<u>-</u>	<u>-</u>	<u>1,757,665</u>
Total expenses and other deductions	<u>74,390,284</u>	<u>-</u>	<u>-</u>	<u>74,390,284</u>
Change in net assets from operating activities	<u>5,130,308</u>	<u>202,605</u>	<u>1,304,895</u>	<u>6,637,808</u>
Non-Operating Activities				
Change in fair value of interest rate swap	100,834	-	-	100,834
Contributions for capital expenditures	942,213	654,259	-	1,596,472
Investment return on funds for plant assets	88,241	-	-	88,241
Net assets released from restrictions for capital assets	40,024	(40,024)	-	-
Endowment investment return, in excess of appropriation	<u>1,074,014</u>	<u>1,436,987</u>	<u>-</u>	<u>2,511,001</u>
Change in net assets from non-operating activities	<u>2,245,326</u>	<u>2,051,222</u>	<u>-</u>	<u>4,296,548</u>
Change in Net Assets	7,375,634	2,253,827	1,304,895	10,934,356
Net Assets, Beginning of Year	<u>62,126,769</u>	<u>3,478,028</u>	<u>14,541,371</u>	<u>80,146,168</u>
Net Assets, End of Year	<u>\$ 69,502,403</u>	<u>\$ 5,731,855</u>	<u>\$ 15,846,266</u>	<u>\$ 91,080,524</u>

See Notes to Financial Statements

Mercyhurst College
Statement of Cash Flows
Eleven-Month Period Ended May 31, 2011

Operating Activities	
Change in net assets	\$ 10,934,356
Items not requiring (providing) operating cash flows	
Depreciation and amortization	4,419,295
Net realized and unrealized gains on investments	(4,860,474)
Change in value of split interest agreements	(72,326)
Contributions received restricted for long-term investment	(1,304,895)
Changes in	
Receivables	1,499,297
Inventories	11,949
Prepaid expenses and other assets	164,973
Accounts payable	214,021
Accrued expenses and other liabilities	116,530
Student deposits	269,399
Deferred revenue	(1,745,154)
Federal government advances for student loans	<u>960</u>
Net cash provided by operating activities	<u>9,647,931</u>
Investing Activities	
Purchase of land, buildings and equipment	(4,157,738)
Purchase of long-term investments	(4,460,318)
Proceeds from disposition of long-term investments	4,018,430
Change in deposits with trustees	<u>(17,940)</u>
Net cash used in investing activities	<u>(4,617,566)</u>
Financing Activities	
Principal payments on bonds	(1,820,000)
Principal payments on notes payable	(11,158)
Proceeds from contributions restricted for long-term investment	<u>1,304,895</u>
Net cash used in financing activities	<u>(526,263)</u>
Increase in Cash and Cash Equivalents	4,504,102
Cash and Cash Equivalents, Beginning of Year	<u>11,384,909</u>
Cash and Cash Equivalents, End of Year	<u>\$ 15,889,011</u>
Supplemental Cash Flows Information	
Interest paid	<u>\$ 1,941,937</u>

See Notes to Financial Statements

Mercyhurst College
Notes to Financial Statements
May 31, 2011

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. In fiscal 2011, the College changed its year end from June 30 to May 31.

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.

Operating and Non-Operating Activities

For the purpose of the statement of activities, the College considers its changes in unrestricted net assets to be operational changes, except for the College's interest rate swap and realized and unrealized gains and losses on endowment investments in excess of the College's spending rate. In addition, contributions and investment return received or earned of a capital nature, that is, to be used for facilities and equipment or to be invested by the College to generate a return that will support operations, are included in non-operating activities and classified as unrestricted, temporarily restricted, or permanently restricted net assets. Gains and losses related to the sale or disposal of facilities and equipment are also recorded in this category.

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 May 31, 2011, cash equivalents consisted primarily of money market accounts with brokers and certificates of deposit.

Effective July 21, 2010, the FDIC's insurance limits were permanently increased to \$250,000. At May 31, 2011, the College's cash accounts exceeded federally insured limits by approximately \$15,747,386.

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Notes to Financial Statements
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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. 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.

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 five to seven days 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 or twelve 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.

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Land, Buildings and Equipment

Land is recorded at cost and not depreciated. Land improvements, 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.

The College capitalizes interest costs as a component of construction in progress, based on interest costs of borrowing specifically for the project, net of interest earned on investments acquired with the proceeds of the borrowing. Total interest capitalized in 2011 was:

Total interest expense incurred on borrowings for project	\$ 8,763
Interest income from investment of proceeds of borrowings for project	_____ -
Net interest cost capitalized	<u>\$ 8,763</u>

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.

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.

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Notes to Financial Statements
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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.

Federal Government Advances 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.

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.

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The College files tax returns in the U.S. Federal jurisdiction. With a few exceptions, the College is no longer subject to U.S. Federal examinations by tax authorities for years before 2007.

Note 2: Contributions Receivable and Conditional Gifts

Contributions receivable consisted of the following:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Due within one year	\$ 265,276	\$ 143,179	\$ 120,633	\$ 529,088
Due in one to five years	711,287	104,421	981,451	1,797,159
Due in more than five years	<u>—</u>	<u>37,667</u>	<u>260,750</u>	<u>298,417</u>
	976,563	285,267	1,362,834	2,624,664
Less				
Allowance for uncollectible contributions	(20,427)	(5,984)	(28,589)	(55,000)
Unamortized discount	<u>(132,845)</u>	<u>(36,411)</u>	<u>(274,385)</u>	<u>(443,641)</u>
	<u>\$ 823,291</u>	<u>\$ 242,872</u>	<u>\$ 1,059,860</u>	<u>\$ 2,126,023</u>

The discount rate used was 6%.

The College has been named in will commitments totaling \$2,745,500 at May 31, 2011 which are not reflected in the financial statements, as they are considered conditional promises to give.

Note 3: Beneficial Interest in 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 May 31, 2011, the College's beneficial interest in the remainder trust administered by an outside party is \$574,927.

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Notes to Financial Statements
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Note 4: Long-Term Investments and Investment Return

Investments, including deposits with trustees, at May 31, 2011 consisted of the following:

Money market mutual funds	\$ 1,831,535
Fixed income mutual funds	6,378,621
Corporate bonds	1,468,560
Equity mutual funds	
Index funds	4,814,919
Growth funds	1,637,464
Value funds	2,849,092
Blended funds	2,772,092
International funds	3,151,822
Equity securities	1,981,849
Hedge fund-of-funds	2,374,228
Other	<u>422,168</u>
	<u>\$ 29,682,350</u>

Total investment return is comprised of the following:

Interest and dividend income	\$ 562,267
Net realized and unrealized gains and losses	<u>4,860,474</u>
	<u>\$ 5,422,741</u>

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Notes to Financial Statements
May 31, 2011

Alternative Investments

The fair value of the Hedge fund-of-funds has been estimated using the net asset value per share of the investments. Alternative investments held at May 31, 2011 consist of the following:

	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
PA Stable Value Fund (A)	\$ 1,143,580	\$ -	Annual	Last business day in October for a December 31 redemption
Common Sense Fund (B)	\$ 1,230,648	\$ -	Annual	100 days

- (A) This category includes an investment in a hedge fund that pursues multiple strategies to diversify risks and reduce volatility. The fund's composite portfolio includes investments in U.S. common stocks, global real estate projects, arbitrage investments, fixed income and other related strategies. There are no redemption restrictions for the investment.
- (B) This category includes an investment in a hedge fund that takes both long and short positions, primarily in U.S. common stocks. Management of the funds has the ability to shift investments among differing investment strategies. There are no redemption restrictions for the investment.

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Note 5: Endowment

The College's endowment consists of 175 individual funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments (board-designated endowment funds). As required by accounting principles generally accepted in the United States of America (GAAP), net assets associated with endowment funds, including board-designated endowment funds, are classified and reported based on the existence or absence of donor-imposed restrictions.

The composition of net assets by type of endowment fund at May 31, 2011 consisted of the following:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (916,919)	\$ 3,343,785	\$ 15,846,266	\$ 18,273,132
Board-designated endowment funds	<u>8,997,000</u>	<u>-</u>	<u>-</u>	<u>8,997,000</u>
Total endowment funds	<u>\$ 8,080,081</u>	<u>\$ 3,343,785</u>	<u>\$ 15,846,266</u>	<u>\$ 27,270,132</u>

Changes in endowment net assets for the eleven-month period ended May 31, 2011 was as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	<u>\$ 7,006,067</u>	<u>\$ 1,792,128</u>	<u>\$ 14,541,371</u>	<u>\$ 23,339,566</u>
Investment return:				
Investment income	118,037	270,534	-	388,571
Net appreciation	<u>1,378,438</u>	<u>1,974,196</u>	<u>-</u>	<u>3,352,634</u>
Total investment return	<u>1,496,475</u>	<u>2,244,730</u>	<u>-</u>	<u>3,741,205</u>
Contributions	-	42,344	1,304,895	1,347,239
Appropriation of endowment assets for expenditure	(422,461)	(807,743)	-	(1,230,204)
Other changes – Change in value of split interest agreement	<u>-</u>	<u>72,326</u>	<u>-</u>	<u>72,326</u>
Endowment net assets, end of year	<u>\$ 8,080,081</u>	<u>\$ 3,343,785</u>	<u>\$ 15,846,266</u>	<u>\$ 27,270,132</u>

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Amounts of donor-restricted endowment funds classified as permanently and temporarily restricted net assets at May 31, 2011 consisted of:

Permanently restricted net assets – portion of perpetual endowment funds required to be retained permanently by explicit donor stipulation	<u>\$ 15,846,266</u>
Temporarily restricted net assets	
Portion of perpetual endowment funds subject to a time restriction	
With purpose restrictions	\$ 2,876,955
Without purpose restrictions	<u>466,830</u>
	<u>\$ 3,343,785</u>

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level the College is required to retain as a fund of perpetual duration pursuant to donor stipulation. In accordance with GAAP, deficiencies of this nature are reported in unrestricted net assets and aggregated \$916,919 at May 31, 2011. These deficiencies resulted from unfavorable market fluctuations, and continued appropriation for certain purposes that was deemed prudent by the Board of Trustees.

The College has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to student scholarships and other programs supported by its endowment while seeking to maintain the purchasing power of the endowment. Endowment assets include those assets of donor-restricted endowment funds the College must hold in perpetuity or for donor-specified periods, as well as those of board-designated endowment funds. Under the College's policies, endowment assets are invested in a manner that is intended to produce results that exceed inflation while assuming a moderate level of investment risk. The College expects its endowment funds to provide an average rate of return of approximately CPI plus 2% annually over time. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate of return objectives, the College relies on a total return strategy in which investment returns are achieved through both current yield (investment income such as dividends and interest) and capital appreciation (both realized and unrealized). The College targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

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The College has a policy (the spending policy) of appropriating for expenditure each year 4.5% of invested endowment assets using a rolling quarter average market value calculation through March 31st of the year preceding the year in which expenditure is planned. For the eleven-month period ending May 31, 2011, the calculation was based on a rolling 18 quarter average market value. Each year the two oldest quarter market values are excluded and the four most recent quarter market values are added until such year as the calculation is based on a rolling 20 quarter average market value. In order to fund the costs of the College's current capital campaign, the College amended the spending policy in November of 2009 to permit an additional 1.5% of invested endowment assets based on a rolling quarter average market value, as noted above, over each of the next 10 years subject to the annual amount shall not exceed one third of the funds raised for the endowment in cash and pledges during the previous twelve months. In establishing this policy, the College considered the long-term expected return on its endowment. Accordingly, over the long term, the College expects the current spending policy to allow its endowment to grow at an average of CPI plus 2% annually. This is consistent with the College's objective to maintain the purchasing power of endowment assets held in perpetuity or for a specified term, as well as to provide additional real growth through new gifts and investment return.

Note 6: Land, Buildings, and Equipment

Land, buildings, and equipment at May 31, 2011 consist of:

Land	\$ 3,934,567
Land improvements	9,552,923
Buildings	103,325,786
Furnishings and equipment	23,086,209
Library books	4,661,802
Construction-in-progress	<u>648,779</u>
	145,210,066
Less: accumulated depreciation	<u>54,096,088</u>
	<u>\$ 91,113,978</u>

Note 7: Disclosures About Fair Value of Assets and Liabilities

ASC Topic 820, *Fair Value Measurements*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820 also specifies a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

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Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the valuation methodologies and inputs used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying statements of financial position, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy.

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include money market mutual funds, mutual funds and equity securities. If quoted market prices are not available, then fair values are estimated by a third party pricing service using pricing models, quoted market prices of securities with similar characteristics or discounted cash flows. For investments, other than alternative investments, the inputs used by the pricing service to determine fair value may include one, or a combination of, observable inputs such as benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data market research publications and are classified within Level 2 of the valuation hierarchy. Level 2 securities include fixed income securities and certain trusts. For alternative investments that have sufficient activity or liquidity within the fund, fair value is determined using the net asset value (or its equivalent) provided by the fund and are classified within Level 2 of the valuation hierarchy. For alternative investments that do not have sufficient activity or liquidity within the fund, the net asset value (or its equivalent) provided by the fund is utilized, as a practical expedient, to determine fair value and are classified within Level 3 of the valuation hierarchy. Level 3 securities include hedge funds and private investment trusts.

Interest Rate Swap Agreement

The fair value is estimated using forward-looking interest rate curves and discounted cash flows that are observable or that can be corroborated by observable market data and, therefore, are classified within Level 2 of the valuation hierarchy.

Beneficial Interest in Charitable Remainder Trusts

Fair value is estimated at the present value of the future distributions expected to be received over the term of the agreement. Due to the nature of the valuation inputs, the interest is classified within Level 2 of the hierarchy.

Mercyhurst College
Notes to Financial Statements
May 31, 2011

The following tables present the fair value measurements of assets and liabilities recognized in the accompanying statement of financial position measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at May 31, 2011:

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market mutual funds	\$ 16,056,820	\$ 16,056,820	\$ -	\$ -
Beneficial interest in charitable remainder trust	574,927	-	574,927	-
Fixed income mutual funds	6,378,621	6,378,621	-	-
Corporate bonds	1,468,560	-	1,468,560	-
Equity mutual funds				
Index funds	4,814,919	4,814,919	-	-
Growth funds	1,637,464	1,637,464	-	-
Value funds	2,849,092	2,849,092	-	-
Blended funds	2,772,092	2,772,092	-	-
International funds	3,151,822	3,151,822	-	-
Equity securities	1,981,849	1,981,849	-	-
Hedge fund-of-funds	2,374,228	-	-	2,374,228
Other investments	422,168	-	422,168	-
Interest rate swap agreement	(204,166)	-	(204,166)	-

Mercyhurst College
Notes to Financial Statements
May 31, 2011

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying statement of financial position using significant unobservable (Level 3) inputs:

	PA Stable Value Fund	Common Sense Fund
Balance, July 1, 2010	\$ 1,045,644	\$ 1,171,793
Total realized and unrealized gains included in change in net assets	97,936	58,855
Balance, May 31, 2011	\$ 1,143,580	\$ 1,230,648
Total gains for the period included in change in net assets attributable to the change in unrealized gains or losses relating to assets still held at the statement of financial position date		
	\$ 156,791	

Realized and unrealized gains and losses are included in change in net assets.

Note 8: Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities at May 31, 2011 consist of:

Accrued payroll and deferred compensation	\$ 2,489,918
Accrued payroll taxes and withholdings	349,387
Accrued vacation	694,518
Other accrued expenses	158,626
	\$ 3,692,449

Mercyhurst College
Notes to Financial Statements
May 31, 2011

Note 9: Long-term Debt

Long-term debt at May 31, 2011 consists of the following:

Notes payable	
Lines of credit	<u>\$ 1,432,648</u>
Capital lease obligation	
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>140,564</u>
Bonds payable	
Pennsylvania Higher Education Facilities Authority Revenue Bonds Series 1999 E1, maturing at varying amounts through 2020, with interest at 0.18% at May 31, 2011 and at variable rates thereafter that are based upon the Securities Industry and Financial Markets Association (SIFMA) index	2,000,000
Pennsylvania Higher Education Facilities Authority Revenue Bonds Series 2001 I2, maturing at varying amounts through 2022, with interest at 0.18% at May 31, 2011 and at variable rates thereafter that are based upon the SIFMA index	4,100,000
College Revenue Bonds of 2003, maturing at varying amounts through 2024, with interest at a swap rate of 3.82% at May 31, 2011 until November 1, 2012, and at variable rates thereafter that are based upon the SIFMA index	4,200,000
College Revenue Refunding Bonds Series A and B of 2004, maturing at varying amounts through 2023, with interest rates ranging from 4.10% to 5.00%	11,225,000
College Revenue Bonds of 2008, maturing at varying amounts through 2038, with interest rates ranging from 4.00% to 5.50%	<u>21,970,000</u>
Total bonds payable	<u>43,495,000</u>
Total long-term debt	<u>\$ 45,068,212</u>

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 May 31, 2013. 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,

Mercyhurst College
Notes to Financial Statements
May 31, 2011

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 May 31, 2013. 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 May 31, 2011 the balance outstanding under the lines of credit was \$1,432,948.

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 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) 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,

Mercyhurst College
Notes to Financial Statements
May 31, 2011

(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 1997 Bond proceeds were used to finance a project consisting 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.

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 \$2,036,667. 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 \$4,175,167. 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 \$4,278,400. The letter of credit expires July 1, 2012 and is renewable thereafter.

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 2012 to \$300,000 in 2020 at maturity.
- *2001 Bonds* — Ranging from \$300,000 in 2012 to \$500,000 in 2022 at maturity.
- *2003 Bonds* — Ranging from \$200,000 in 2012 to \$400,000 in 2024 at maturity.
- *2004 Series A Bonds* – Ranging from \$935,000 in 2012 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 \$240,000 in 2012 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.

Mercyhurst College
Notes to Financial Statements
May 31, 2011

Aggregate annual maturities and sinking fund requirements of long-term debt and payments on capital lease obligations at May 31, 2011:

	Long-term debt (excluding leases)	Capital Lease Obligations
2012	\$ 2,280,000	\$ 35,820
2013	3,872,948	35,820
2014	2,500,000	35,820
2015	2,585,000	35,820
2016	2,760,000	35,820
Thereafter	30,930,000	44,775
	\$ 44,927,948	223,875
Less amount representing interest payments		83,311
		\$ 140,564

Note 10: 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 \$4,200,000 at May 31, 2011. 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.

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 2018.

Total rental expense for 2011 was \$2,388,948.

Mercyhurst College
Notes to Financial Statements
May 31, 2011

Future minimum lease payments at May 31, 2011 were:

2012		\$	1,573,404
2013			1,223,914
2014			905,584
2015			597,589
2016			393,910
Thereafter			<u>154,905</u>
		<u>\$</u>	<u>4,849,306</u>

Note 12: 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 13: 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. Effective June 1, 2011, the plan eliminated VALIC as an investment manager eligible to receive new contributions under the plan. Plan participants with accounts at VALIC established new accounts at TIAA-CREF to continue to make monthly contributions and receive matching contributions from the College to fund retirement benefits. The plan covers a majority of all eligible employees. The College's share of the cost of these benefits for the eleven-month period ended May 31, 2011 was \$1,166,945.

Mercyhurst College
Notes to Financial Statements
May 31, 2011

Note 14: 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 15: 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 May 31, 2011 are available for the following purposes or future periods:

Institutional support	\$ 2,221,948
Instruction	1,472,987
Academic support	7,559
Scholarships	205,710
Plant operations and additions	1,783,892
Public service	<u>39,759</u>
	<u>\$ 5,731,855</u>

Permanently Restricted Net Assets

Permanently restricted net assets at May 31, 2011 are restricted to investments in perpetuity, the income from which is expendable to support:

Institutional support	\$ 3,613,782
Scholarships	10,375,251
Instructional	1,687,024
Student services	108,000
Public service	<u>62,209</u>
	<u>\$ 15,846,266</u>

Mercyhurst College
Notes to Financial Statements
May 31, 2011

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.

Purpose of restrictions accomplished:	
Instructional activities	\$ 53,169
Academic support	221
Institutional support	100,849
Operation and maintenance of plant	202,801
Scholarships	<u>794,216</u>
	1,151,256
Plant fund expenditures	<u>40,024</u>
	<u>\$ 1,191,280</u>

Note 16: Expense Summary

Expenses classified by natural classification are summarized as follows:

Salaries and wages	\$ 28,960,824
Fringe benefits	9,181,177
Contract services	5,449,762
Conferences and seminars	618,847
Meetings and events	611,366
Supplies	1,110,993
Travel	1,341,552
Repairs and maintenance	1,200,225
Utilities	2,044,468
Cost of sales for auxiliary enterprises	6,436,914
Bad debts	458,333
Rents and leases	2,388,948
Non-capital equipment	1,517,452
Interest on indebtedness	1,757,665
Insurance	762,340
Depreciation and amortization	4,419,295
Other	<u>6,130,123</u>
	<u>\$ 74,390,284</u>

Mercyhurst College
Notes to Financial Statements
May 31, 2011

Note 17: Functional Expenses

The College's expenses on a functional basis, allocating interest to the appropriate functions and identifying fundraising, are as follows:

Instruction	\$ 30,449,116
Public service	220,133
Academic support	3,095,053
Student services	14,160,585
Institutional support	10,941,162
Auxiliary enterprises	14,287,759
Fundraising	<u>1,236,476</u>
	<u>\$ 74,390,284</u>

Note 18: Significant Estimates and Concentrations

Current Economic Conditions

The current economic environment presents colleges and universities with unprecedented circumstances and challenges, which in some cases have resulted in large declines in the fair value of investments and other assets, declines in contributions, student financial aid, enrollment revenue, governmental support, grant revenue, constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to the College.

In addition, given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in investment values, allowances for contributions receivable and the valuation of intangibles that could have an adverse impact on the College.

Note 19: Subsequent Events

Subsequent events have been evaluated through October 24, 2011, which is the date the financial statements were issued.

Supplementary Information

Mercyhurst College
Schedule of Expenditures of Federal Awards
Eleven-Month Period Ended May 31, 2011

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		\$ 565,181
Federal Pell Grant Program	84.063		7,369,710
Federal Supplemental Education Opportunity Grant	84.007		361,401
Federal Perkins Loan Program	84.038		2,784,183
Federal Direct Lending Program	84.268		29,480,688
Academic Competitiveness Grant	84.375		208,130
National Science and Mathematics Access to Retain Talent Grant	84.376		104,334
<i>Pass-through from Pennsylvania Department of Education</i>			
Vocational Education Program	84.048	23-600-3115	198,455
Art-Based Teacher ED	84.116Z		<u>1,725</u>
Total Department of Education			41,073,807
Department of Labor			
<i>Pass-through from Pennsylvania Department of Labor</i>			
Trade Adjustment Act Program	17.245	23-600-3107	156,113
Camp Adventures	17.259	20100127	19,778
<i>Pass-through from Pennsylvania Department of Labor/Erie School District</i>			
Temporary Assistance for Needy Families – TAN Games	17.259	1011-TANF-1112	<u>2,210</u>
Total Department of Labor			178,101
Department of Justice			
<i>Pass-through from Pennsylvania Commission on Crime and Delinquency</i>			
Burned Human Remains		2008-DN-BX-K131	71,641
Mass Fatality Scenes		2008-DN-BX-K133	63,890
Parameters in Modern Subadults		2008-DN-BX-D152	7,745
NW Emergency Response Group	16.	GR4100046543	88,296
NW Central PA Emergency 3	16.		285,860
FBI Graduate Certificate in Counterintelligence		#MER1654601	<u>26,137</u>
Total Department of Justice			543,569

Mercyhurst College
Schedule of Expenditures of Federal Awards
Eleven-Month Period Ended May 31, 2011

Department of Health and Human Services			
<i>Pass-through from Pennsylvania Department of Public Welfare/ Erie School District</i>			
Temporary Assistance for Needy Families – TANF Challenge	93.558	1011-TANF-1113	2,020
Executive Office of the President			
Office of National Drug Control Policy – HIDTA	95.001	G09WB0004A	2,165,737
Department of Defense			
Biometrics in the Developing World	12.	H98230-05-D-0101	6,729
CIRAT – Russian IT	12.	H98230-05-D-0101	171
Project Bold Vision	12.	H98230-10-P-2755	73,639
Artifact and Sample Analysis	12.114		37,041
		H98230-05-D-	
Telecommunications Technology	12.	0101/0015	2,413
Vehicle Technologies	12.	H98230-11-C-1439	1,188
Russian Study	12.	H98230-11-C-1439	<u>902</u>
Total Department of Defense			122,083
Department of Commerce			
NOAA Eastern Gulf of Mexico	11.460		5,190
National Science Foundation			
Glacial Lake Ojibway	47.050		2,044
Corporation for National & Community Service			
Learn and Serve America – Glisten Planning Grant	94.018		5,654
National Aeronautics and Space Administration			
NASA Volcanic Processes	43.AAA		24,373
Department of State			
ATA State Department Cooperative Agreement	19.7	SDSASD07CA002	<u>400,435</u>
Total			<u>\$ 44,523,013</u>

Mercyhurst College
Schedule of Expenditures of Federal Awards
Eleven-Month Period Ended May 31, 2011

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. During 2011, the College distributed \$69,974 in Perkins Loans. Perkins Loans outstanding at May 31, 2011, including the portion distributed from College funds, totaled \$2,382,048.
4. The Federal Direct Lending Program consists of subsidized and unsubsidized Federal Loans (for students) and Federal PLUS Loans (for parents and graduate students). Federal statute requires that proceeds from Federal Direct Lending Loans (subsidized, unsubsidized, and PLUS) be disbursed to the College to be directly applied to students' accounts. New loans processed for students during the eleven month period ended May 31, 2011 were as follows:

Federal Direct Lending Program	
Subsidized	\$ 11,976,533
Unsubsidized	13,133,188
PLUS	<u>4,370,967</u>
	<u>\$ 29,480,688</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 (the College) as of and for the eleven-month period ended May 31, 2011, and have issued our report thereon dated October 24, 2011. 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 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 College's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the College's internal control over financial reporting.

A deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the College's financial statements will not be prevented or detected and corrected on a timely basis.

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 deficiencies, 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 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 October 24, 2011.

This report is intended solely for the information and use of the governing body, management and others within the College and is not intended to be and should not be used by anyone other than these specified parties.

BKD, LLP

October 24, 2011

**Independent Accountants' Report on Compliance with Requirements
That Could Have a Direct and Material Effect on Each Major Program and
on Internal Control Over Compliance in Accordance with OMB Circular A-133**

Board of Trustees
Mercyhurst College
Erie, Pennsylvania

Compliance

We have audited the compliance of Mercyhurst College (the College) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the eleven-month period ended May 31, 2011. 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 compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the eleven-month period ended May 31, 2011.

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 College'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 and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 College's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, 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, others within the College and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

BKD, LLP

October 24, 2011

Mercyhurst College
Schedule of Findings and Questioned Costs
Eleven-Month Period Ended May 31, 2011

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:
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

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
Eleven-Month Period Ended May 31, 2011

7. The Organization's major programs were:

Cluster/Program	CFDA Number
Student Financial Aid Cluster	84.033, 84.063, 84.007, 84.038, 84.268, 84.375, 84.376
ATA State Department Cooperative Agreement	19.7

8. The threshold used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133 was \$300,000.

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
Eleven-Month Period Ended May 31, 2011

Findings Required to be Reported by *Government Auditing Standards*

Reference Number	Finding	Questioned Costs
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No matters are reportable.

Findings Required to be Reported by OMB Circular A-133

Reference Number	Finding	Questioned Costs
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No matters are reportable.

Mercyhurst College
Summary Schedule of Prior Audit Findings
Eleven-Month Period Ended May 31, 2011

Reference Number	Summary of Finding	Status
10-01	Year-end reconciliations were not performed between Student Financial Aid records, School Account Statements (SAS) monthly reports from the Common Origination and Disbursement system and the general ledger.	Corrected