

# **Mercyhurst University**

Auditor's Reports and Consolidated Financial Statements

May 31, 2013 and 2012



**Mercyhurst University**  
**May 31, 2013 and 2012**

**Contents**

<b>Independent Auditor’s Report on Consolidated Financial Statements and Supplementary Information .....</b>	<b>1</b>	
 <b>Consolidated Financial Statements</b>		
Statements of Financial Position .....	3	
Statements of Activities .....	4	
Statements of Cash Flows.....	6	
Notes to Financial Statements.....	7	
 <b>Supplementary Information</b>		
Schedule of Expenditures of Federal Awards .....	32	
 <b>Independent Auditor’s 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 .....</b>		<b>34</b>
 <b>Independent Auditor’s 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.....</b>		<b>36</b>
<b>Schedule of Findings and Questioned Costs.....</b>	<b>38</b>	
 <b>Summary Schedule of Prior Audit Findings.....</b>	 <b>42</b>	

## Independent Auditor's Report on Consolidated Financial Statements and Supplementary Information

Board of Trustees  
Mercyhurst University  
Erie, Pennsylvania

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Mercyhurst University, which comprise the consolidated statements of financial position as of May 31, 2013 and 2012, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mercyhurst University as of May 31, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## ***Supplementary Information***

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal awards required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

## ***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2013, on our consideration of the University'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* in considering Mercyhurst University's internal control over financial reporting and compliance.

*BKD, LLP*

Cincinnati, Ohio  
October 25, 2013

**Mercyhurst University**  
**Consolidated Statements of Financial Position**  
**May 31, 2013 and 2012**

	2013	2012
<b>Assets</b>		
Cash and cash equivalents	\$ 12,692,331	\$ 14,956,298
Accounts receivable, net of allowance; 2013 - \$550,000, 2012 - \$723,805	2,111,582	3,012,684
Contributions receivable, net	1,611,531	2,014,498
Beneficial interest in charitable remainder trust	691,403	575,978
Loans receivable, net of allowance; 2013 and 2012 - \$118,677	2,396,320	2,386,886
Inventories	425,708	505,163
Prepaid expenses and other assets	338,056	380,135
Bond discount and issuance costs, net	444,512	488,063
Deposits with trustees	3,063,686	3,061,646
Long-term investments	29,852,993	24,945,722
Land, buildings and equipment, net	98,597,032	96,641,764
Total assets	\$ 152,225,154	\$ 148,968,837
<b>Liabilities and Net Assets</b>		
<b>Liabilities</b>		
Accounts payable	\$ 2,244,163	\$ 2,792,994
Accrued expenses and other liabilities	4,384,555	4,128,601
Accrued interest	342,595	408,511
Student deposits	1,324,483	1,552,468
Deferred revenue	360,633	311,021
Notes payable and capital leases	1,314,079	1,330,735
Bonds and bank note payable	38,775,000	41,215,000
Federal government advances for student loans	2,264,652	2,269,786
Trusts payable	44,888	44,370
Total liabilities	51,055,048	54,053,486
<b>Net Assets</b>		
Unrestricted	79,869,073	72,935,718
Temporarily restricted	4,134,084	5,134,156
Permanently restricted	17,166,949	16,845,477
Total net assets	101,170,106	94,915,351
Total liabilities and net assets	\$ 152,225,154	\$ 148,968,837

*See Notes to Consolidated Financial Statements*

**Mercyhurst University**  
**Consolidated Statement of Activities**  
**Year Ended May 31, 2013**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Revenues, Gains and Other Support</b>				
Tuition and fees	\$ 96,610,087	\$ -	\$ -	\$ 96,610,087
Less: university funded financial aid	45,600,221	-	-	45,600,221
Net tuition and fees	51,009,866	-	-	51,009,866
Government grants and other contracts	9,013,975	-	-	9,013,975
Private gifts	870,476	193,869	321,472	1,385,817
Appropriation of endowment investment return	10,227	953,297	-	963,524
Other investment return	822,193	234,480	-	1,056,673
Other revenues	1,521,143	-	-	1,521,143
Auxiliary enterprises	22,960,197	-	-	22,960,197
Change in value of split interest agreements	-	114,907	-	114,907
Net assets released from restrictions	1,418,320	(1,418,320)	-	-
Total revenues, gains and other support	87,626,397	78,233	321,472	88,026,102
<b>Expenses and Other Deductions</b>				
Instruction	38,336,166	-	-	38,336,166
Public service	266,670	-	-	266,670
Academic support	3,656,715	-	-	3,656,715
Student services	15,152,985	-	-	15,152,985
Institutional support	12,299,731	-	-	12,299,731
Auxiliary enterprises	14,371,803	-	-	14,371,803
Interest	1,849,563	-	-	1,849,563
Total expenses and other deductions	85,933,633	-	-	85,933,633
Change in net assets from operating activities	1,692,764	78,233	321,472	2,092,469
<b>Non-Operating Activities</b>				
Change in fair value of interest rate swap	60,702	-	-	60,702
Contributions for capital expenditures	74,770	138,595	-	213,365
Grants and contracts for capital expenditures	1,018,104	-	-	1,018,104
Investment return on funds for plant assets	71,251	-	-	71,251
Net loss on retirement of assets	(113,280)	-	-	(113,280)
Net assets released from restrictions for capital assets	2,137,669	(2,137,669)	-	-
Endowment investment return, in excess of appropriation	1,991,375	920,769	-	2,912,144
Change in net assets from non-operating activities	5,240,591	(1,078,305)	-	4,162,286
<b>Change in Net Assets</b>	6,933,355	(1,000,072)	321,472	6,254,755
<b>Net Assets, Beginning of Year</b>	72,935,718	5,134,156	16,845,477	94,915,351
<b>Net Assets, End of Year</b>	\$ 79,869,073	\$ 4,134,084	\$ 17,166,949	\$ 101,170,106

*See Notes to Consolidated Financial Statements*

**Mercyhurst University**  
**Consolidated Statement of Activities**  
**Year Ended May 31, 2012**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Revenues, Gains and Other Support</b>				
Tuition and fees	\$ 92,406,092	\$ -	\$ -	\$ 92,406,092
Less: university funded financial aid	43,059,125	-	-	43,059,125
Net tuition and fees	49,346,967	-	-	49,346,967
Government grants and other contracts	8,594,539	-	-	8,594,539
Private gifts	831,898	879,142	259,499	1,970,539
Appropriation of endowment investment return	95,493	924,192	-	1,019,685
Other investment return	272,321	1,397	-	273,718
Other revenues	1,694,323	-	-	1,694,323
Auxiliary enterprises	21,811,526	-	-	21,811,526
Change in value of split interest agreements	-	197,731	-	197,731
Reclassification of net assets	-	(739,712)	739,712	-
Net assets released from restrictions	1,420,073	(1,420,073)	-	-
Total revenues, gains and other support	84,067,140	(157,323)	999,211	84,909,028
<b>Expenses and Other Deductions</b>				
Instruction	35,674,684	-	-	35,674,684
Public service	266,889	-	-	266,889
Academic support	3,254,235	-	-	3,254,235
Student services	14,189,546	-	-	14,189,546
Institutional support	11,717,026	-	-	11,717,026
Auxiliary enterprises	14,526,055	-	-	14,526,055
Interest	1,802,580	-	-	1,802,580
Total expenses and other deductions	81,431,015	-	-	81,431,015
Change in net assets from operating activities	2,636,125	(157,323)	999,211	3,478,013
<b>Non-Operating Activities</b>				
Change in fair value of interest rate swap	143,464	-	-	143,464
Contributions for capital expenditures	250,471	532,909	-	783,380
Grants and contracts for capital expenditures	2,081,189	-	-	2,081,189
Investment return on funds for plant assets	60,218	-	-	60,218
Net assets released from restrictions for capital assets	31,402	(31,402)	-	-
Endowment investment return, in excess of appropriation	(1,769,554)	(941,883)	-	(2,711,437)
Change in net assets from non-operating activities	797,190	(440,376)	-	356,814
<b>Change in Net Assets</b>	3,433,315	(597,699)	999,211	3,834,827
<b>Net Assets, Beginning of Year</b>	69,502,403	5,731,855	15,846,266	91,080,524
<b>Net Assets, End of Year</b>	\$ 72,935,718	\$ 5,134,156	\$ 16,845,477	\$ 94,915,351

*See Notes to Consolidated Financial Statements*

**Mercyhurst University**  
**Consolidated Statements of Cash Flows**  
**Years Ended May 31, 2013 and 2012**

	2013	2012
<b>Operating Activities</b>		
Change in net assets	\$ 6,254,755	\$ 3,834,827
Items not requiring (providing) operating activities cash flows		
Depreciation and amortization	4,516,121	4,476,493
Net realized and unrealized (gains) losses on investments	(4,290,597)	1,895,891
Change in value of split interest agreements	(114,907)	(197,731)
Contributions received restricted for long-term investment	(321,472)	(259,499)
Changes in		
Receivables	1,294,635	1,052,608
Inventories	79,455	(58,268)
Prepaid expenses and other assets	42,079	51,079
Accounts payable	(548,831)	483,449
Accrued expenses and other liabilities	190,038	250,810
Student deposits	(227,985)	(124,301)
Deferred revenue	49,612	78,683
Federal government advances for student loans	(5,134)	1,894
Net cash provided by operating activities	6,917,769	11,485,935
<b>Investing Activities</b>		
Purchase of land, buildings and equipment	(6,427,838)	(9,881,361)
Purchase of long-term investments	(6,597,876)	(6,989,011)
Proceeds from disposition of long-term investments	5,981,202	6,679,047
Change in deposits with trustees	(2,040)	89,055
Net cash used in investing activities	(7,046,552)	(10,102,270)
<b>Financing Activities</b>		
Principal payments on bonds	(2,440,000)	(2,280,000)
Principal payments on notes payable	(16,656)	(242,777)
Proceeds from issuance of bank note	-	9,600,000
Payments for retirement of bonds	-	(9,600,000)
Payments for bond issuance costs	-	(53,100)
Proceeds from contributions restricted for long-term investment	321,472	259,499
Net cash used in financing activities	(2,135,184)	(2,316,378)
<b>Decrease in Cash and Cash Equivalents</b>	(2,263,967)	(932,713)
<b>Cash and Cash Equivalents, Beginning of Year</b>	14,956,298	15,889,011
<b>Cash and Cash Equivalents, End of Year</b>	\$ 12,692,331	\$ 14,956,298
<b>Supplemental Cash Flows Information</b>		
Interest paid	\$ 1,798,969	\$ 1,966,594
Income taxes paid	\$ 27,487	\$ 15,515

*See Notes to Consolidated Financial Statements*

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

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

***Nature of Operations***

Mercyhurst University ("University") 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 University's revenues are derived from tuition and fees charged to students. In fiscal 2012, the institution attained University status.

***Principles of Consolidation***

The consolidated financial statements include the accounts of the University and Mercyhurst College, Ireland ("MCI"). MCI was incorporated under the Companies Acts 1963 to 2009 of Ireland as a company limited by guarantee on March 12, 2012. MCI is located at Dungarvan Enterprise Centre, Dungarvan, County Waterford, Ireland. The purpose of MCI is threefold: 1. to offer term-length undergraduate courses to U.S. students through its Centre for International Education; 2. to provide graduate training and certificate programs in analytics and competitive intelligence to students from the European Union through its Center for Intelligence Research Analysis and Training ("CIRAT") Europe; and 3. to deliver courses, in cooperation with Irish Universities, through its Centre for International Academic Partnerships. All significant intercompany accounts and transactions have been eliminated in consolidation.

***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 consolidated statement of activities, the University considers its changes in unrestricted net assets to be operational changes, except for the University's interest rate swap and realized and unrealized gains and losses on endowment investments in excess of the University's spending rate. In addition, contributions, grants and contracts, 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 University 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 and Cash Equivalents***

With the exception of certain investments held in the endowment fund, the University considers all liquid investments with original maturities of three months or less to be cash equivalents. At May 31, 2013 and 2012, cash equivalents consisted primarily of money market accounts with brokers and certificates of deposit.

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

At May 31, 2013, the University's cash accounts exceeded federally insured limits by approximately \$12,453,000.

***Fair Value of Financial Instruments***

The University'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 University 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 University 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 University 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 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.

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

The University 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.

***Deferred Revenue***

Deferred revenue represents unearned student fees and advances on grants and contract awards for which the University has not met all of the applicable eligibility requirements.

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

Temporarily restricted net assets are those whose use by the University 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 University in perpetuity. Generally, the donors of these assets permit the University 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.

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 consolidated financial statements. The University's collections consist primarily of paintings, sculptures, and other works of art, books, and antique furniture.

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

***Inventory Pricing***

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

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

The University 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 University 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.

***Accreditation***

The University is accredited by the Middle States Commission on Higher Education (MSCHE). The University was re-accredited in June 2013. The University was required to submit a follow-up monitoring report on September 1, 2013 regarding Standard 2, incorporating the use of assessment results in budgeting and planning and Standards 7 and 14, assessing student and institutional effectiveness. A small team visit occurred on September 19, 2013. MSCHE is scheduled to meet in November 2013 to review the team report.

***Income Taxes***

The University 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 University is subject to federal income tax on any unrelated business income.

The University files tax returns in the U.S. Federal jurisdiction. With a few exceptions, the University is no longer subject to U.S. Federal examinations by tax authorities for years before 2009.

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

***Self Insurance***

The University has elected to self-insure certain costs related to employee health and accident benefit programs. Costs resulting from noninsured losses are charged to income when incurred. The University has purchased insurance that limits its exposure for individual claims and that limits its aggregate exposure to approximately \$3,500,000.

***Reclassifications of Net Assets***

During 2012 a charitable remainder trust donated to the University was dissolved by the donor and the proceeds were recorded in a temporarily restricted account. Pursuant to a change in the donor's restriction to establish a permanent endowed chair, \$605,683 of the proceeds received was reclassified to the permanently restricted fund.

In addition, an endowed scholarship agreement requires that any unspent earnings remaining in the temporarily restricted account be transferred to the permanently restricted portion of the scholarship account. In fiscal year 2012, \$134,029 was transferred to the permanently restricted fund.

Those net assets were reclassified in the consolidated financial statements to appropriately recognize the restricted nature of the net asset balances:

	2013	2012
Temporarily restricted	—	(739,712)
Permanently restricted	—	739,712

***Financial Statement Reclassifications***

Certain reclassifications have been made to the 2012 consolidated financial statements to conform to the 2013 consolidated financial statement presentation. These reclassifications had no effect on the change in net assets.

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

**Note 2: Contributions Receivable and Conditional Gifts**

Contributions receivable consisted of the following:

	<b>May 31, 2013</b>			<b>Total</b>
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
Due in:				
One year	\$ 116,174	\$ 49,492	\$ 360,083	\$ 525,749
One to five years	404,995	210,388	924,117	1,539,500
More than five years	—	13,604	4,750	18,354
	<u>521,169</u>	<u>273,484</u>	<u>1,288,950</u>	<u>2,083,603</u>
Less:				
Allowance for uncollectible contributions	25,013	13,126	61,861	100,000
Unamortized discount	86,714	53,465	231,893	372,072
	<u>\$ 409,442</u>	<u>\$ 206,893</u>	<u>\$ 995,196</u>	<u>\$ 1,611,531</u>

	<b>May 31, 2012</b>			<b>Total</b>
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
Due in:				
One year	\$ 304,038	\$ 68,140	\$ 109,634	\$ 481,812
One to five years	509,207	277,385	1,143,806	1,930,398
More than five years	—	25,667	7,750	33,417
	<u>813,245</u>	<u>371,192</u>	<u>1,261,190</u>	<u>2,445,627</u>
Less:				
Allowance for uncollectible contributions	19,043	8,207	27,750	55,000
Unamortized discount	101,811	61,291	213,027	376,129
	<u>\$ 692,391</u>	<u>\$ 301,694</u>	<u>\$ 1,020,413</u>	<u>\$ 2,014,498</u>

The discount rate used was 6% for 2013 and 2012.

The University has been named in will commitments totaling \$2,930,400 at May 31, 2013 and \$2,780,000 at May 31, 2012 which are not reflected in the consolidated financial statements, as they are considered conditional promises to give.

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

**Note 3: Beneficial Interest in Charitable Remainder Trust**

The University is the beneficiary under a charitable remainder trust for which it is not the trustee. The University'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, 2013 and 2012, the University's beneficial interest in the remainder trust administered by an outside party is \$691,403 and \$575,978, respectively.

**Note 4: Long-Term Investments and Investment Return**

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

	<u>2013</u>	<u>2012</u>
Money market mutual funds	\$ 1,651,716	\$ 1,638,250
Equity securities	1,798,226	1,392,723
U.S. Treasury securities	1,478,820	1,476,341
Equity mutual funds:		
Index funds	5,835,041	3,963,191
Growth funds	4,100	1,653,412
Value funds	2,592,394	3,330,460
Blended funds	3,537,842	1,551,679
International funds	4,720,948	2,731,727
Fixed income mutual funds:		
Aggregate bond intermediate	2,976,810	2,828,328
Aggregate bond	1,563,988	1,367,452
Bank loans	1,349,705	1,243,278
Foreign government bond	1,419,469	1,225,417
Real estate	1,471,139	1,258,790
Hedge fund-of-funds	2,094,313	1,924,152
Other	422,168	422,168
	<u>\$ 32,916,679</u>	<u>\$ 28,007,368</u>

Total investment return is comprised of the following:

Interest and dividend income	\$ 712,995	\$ 538,075
Net realized and unrealized gains and losses	4,290,597	(1,895,891)
	<u>\$ 5,003,592</u>	<u>\$ (1,357,816)</u>

Total investment return is reflected in the statements of activities as follows:

Operating income	\$ 2,020,197	\$ 1,293,403
Nonoperating income (loss)	2,983,395	(2,651,219)
	<u>\$ 5,003,592</u>	<u>\$ (1,357,816)</u>

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

***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, 2013 and 2012 consist of the following:

	<b>May 31, 2013</b>			
	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
PA Stable Value Fund (A)	\$ 1,000,793	\$ —	Semi- Annual	Redemption on June 30 and December 31 with 95 days written notice
Common Sense Fund (B)	\$ 1,093,520	\$ —	Quarterly	Redemption of up to 25% of account on the last day of each calendar quarter of all or any portion as of December 31 with 100 days written notice
	<b>May 31, 2012</b>			
	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
PA Stable Value Fund (A)	\$ 909,307	\$ —	Semi- Annual	Redemption on June 30 and December 31 with 95 days written notice
Common Sense Fund (B)	\$ 1,014,845	\$ —	Quarterly	Redemption of up to 25% of account on the last day of each calendar quarter of all or any portion as of December 31 with 100 days written notice

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

- (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.
- (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.

**Note 5: Endowment**

The University'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 minimum protected endowment of \$500,000 as required by the University's Articles of Incorporation is included in Board-designated endowment funds.

The composition of net assets by type of endowment fund and the changes in endowment net assets for the years ended at May 31, 2013 and 2012 consisted of the following:

	<b>2013</b>			<u>Total</u>
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
Donor restricted endowment funds	\$ (1,389,080)	\$ 2,899,234	\$ 17,166,949	\$ 18,677,103
Board designated endowment funds	<u>9,577,547</u>	<u>—</u>	<u>—</u>	<u>9,577,547</u>
Total endowment funds	<u>\$ 8,188,467</u>	<u>\$ 2,899,234</u>	<u>\$ 17,166,949</u>	<u>\$ 28,254,650</u>

	<b>2012</b>			<u>Total</u>
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
Donor restricted endowment funds	\$ (2,093,616)	\$ 1,859,605	\$ 16,845,477	\$ 16,611,466
Board designated endowment funds	<u>8,404,143</u>	<u>—</u>	<u>—</u>	<u>8,404,143</u>
Total endowment funds	<u>\$ 6,310,527</u>	<u>\$ 1,859,605</u>	<u>\$ 16,845,477</u>	<u>\$ 25,015,609</u>

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

	<b>2013</b>			<u>Total</u>
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
Endowment net assets, beginning of year	\$ 6,310,527	\$ 1,859,605	\$ 16,845,477	\$ 25,015,609
Investment return:				
Investment income	203,795	493,640	—	697,435
Net appreciation	<u>1,797,807</u>	<u>1,380,426</u>	<u>—</u>	<u>3,178,233</u>
Total investment return/(loss)	<u>2,001,602</u>	<u>1,874,066</u>	<u>—</u>	<u>3,875,668</u>
Contributions	—	200	321,472	321,672
Appropriation of endowment assets for expenditure	(10,227)	(953,297)	—	(963,524)
Other changes — Change in value - split interest agreement	—	115,425	—	115,425
Net asset transfers	<u>(113,435)</u>	<u>3,235</u>	<u>—</u>	<u>(110,200)</u>
Endowment net assets, end of year	<u>\$ 8,188,467</u>	<u>\$ 2,899,234</u>	<u>\$ 17,166,949</u>	<u>\$ 28,254,650</u>

	<b>2012</b>			<u>Total</u>
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
Endowment net assets, beginning of year	\$ 8,080,081	\$ 3,343,785	\$ 15,846,266	\$ 27,270,132
Investment return:				
Investment income	203,919	472,081	—	676,000
Net depreciation	<u>(1,877,980)</u>	<u>(491,824)</u>	<u>—</u>	<u>(2,369,804)</u>
Total investment return/(loss)	<u>(1,674,061)</u>	<u>(19,743)</u>	<u>—</u>	<u>(1,693,804)</u>
Contributions	—	1,736	259,499	261,235
Appropriation of endowment assets for expenditure	(95,493)	(924,192)	—	(1,019,685)
Other changes — Change in value - split interest agreement	—	197,731	—	197,731
Net asset transfers	<u>—</u>	<u>(739,712)</u>	<u>739,712</u>	<u>—</u>
Endowment net assets, end of year	<u>\$ 6,310,527</u>	<u>\$ 1,859,605</u>	<u>\$ 16,845,477</u>	<u>\$ 25,015,609</u>

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

Amounts of donor-restricted endowment funds classified as permanently and temporarily restricted net assets at May 31, 2013 and 2012 consisted of:

	2013	2012
Permanently restricted net assets – portion of perpetual endowment funds required to be retained permanently by explicit donor stipulation	<u>\$ 17,166,949</u>	<u>\$ 16,845,477</u>
Temporarily restricted net assets – portion of perpetual endowment funds subject to a time restriction		
With purpose restrictions	\$ 2,051,707	\$ 1,446,833
Without purpose restrictions	<u>847,527</u>	<u>412,772</u>
	<u>\$ 2,899,234</u>	<u>\$ 1,859,605</u>

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level the University 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 \$1,389,080 and \$ 2,093,616 at May 31, 2013 and 2012, respectively. These deficiencies resulted from unfavorable market fluctuations, and continued appropriation for certain purposes that was deemed prudent by the Board of Trustees.

The University 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 University must hold in perpetuity or for donor-specified periods, as well as those of board-designated endowment funds. Under the University’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 University 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 University 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 University 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.

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

The University 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 years ending May 31, 2013 and 2012, the calculation was based on a rolling 20 quarter average market value. In order to fund the costs of the University's current capital campaign, the University 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 University considered the long-term expected return on its endowment. Accordingly, over the long term, the University expects the current spending policy to allow its endowment to grow at an average of CPI plus 2% annually. This is consistent with the University'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, 2013 and 2012 consist of:

	<u>2013</u>	<u>2012</u>
Land	\$ 3,934,567	\$ 3,934,567
Land improvements	10,412,954	9,928,838
Buildings and improvements	116,803,957	103,990,618
Furnishings and equipment	25,008,009	23,872,090
Library books	4,823,410	4,738,886
Construction-in-progress	<u>158,852</u>	<u>8,574,333</u>
	161,141,749	155,039,332
Less: accumulated depreciation	<u>62,544,717</u>	<u>58,397,568</u>
	<u>\$ 98,597,032</u>	<u>\$ 96,641,764</u>

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

**Note 7: Disclosures About Fair Value of Assets and Liabilities**

Fair value is 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. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

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

**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 supported by little or no market activity and are significant to the fair value of the assets or liabilities

***Recurring Measurements***

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying statements 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, 2013 and 2012:

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

	<b>Fair Value Measurements Using</b>			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>May 31, 2013</b>				
Money market mutual funds	\$ 12,472,663	\$ 12,472,663	\$ —	\$ —
Beneficial interest in charitable remainder trust	691,403	—	691,403	—
Equity Securities	1,798,226	1,798,226	—	—
U.S. Treasury securities	1,478,820	1,478,820	—	—
Equity mutual funds:				
Index funds	5,835,041	5,835,041	—	—
Growth funds	4,100	4,100	—	—
Value funds	2,592,394	2,592,394	—	—
Blended funds	3,537,842	3,537,842	—	—
International funds	4,720,948	4,720,948	—	—
Fixed income mutual funds:				
Aggregate bond intermediate	2,976,810	2,976,810	—	—
Aggregate bond	1,563,988	1,563,988	—	—
Bank loans	1,349,705	1,349,705	—	—
Foreign government bond	1,419,469	1,419,469	—	—
Real estate	1,471,139	1,471,139	—	—
Hedge fund-of-funds	2,094,313	—	2,094,313	—
Other investments	422,168	—	422,168	—
	<u>\$ 44,429,029</u>	<u>\$ 41,221,145</u>	<u>\$ 3,207,884</u>	<u>\$ —</u>

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>May 31, 2012</b>				
Money market mutual funds	\$ 14,738,601	\$ 14,738,601	\$ —	\$ —
Beneficial interest in charitable remainder trust	575,978	—	575,978	—
Equity Securities	1,392,723	1,392,723	—	—
U.S. Treasury securities	1,476,341	1,476,341	—	—
Equity mutual funds:				
Index funds	3,963,191	3,963,191	—	—
Growth funds	1,653,412	1,653,412	—	—
Value funds	3,330,460	3,330,460	—	—
Blended funds	1,551,679	1,551,679	—	—
International funds	2,731,727	2,731,727	—	—
Fixed income mutual funds:				
Aggregate bond intermediate	2,828,328	2,828,328	—	—
Aggregate bond	1,367,452	1,367,452	—	—
Bank loans	1,243,278	1,243,278	—	—
Foreign government bond	1,225,417	1,225,417	—	—
Real estate	1,258,790	1,258,790	—	—
Hedge fund-of-funds	1,924,152	—	1,924,152	—
Other investments	422,168	—	422,168	—
Interest rate swap agreement	(60,702)	—	(60,702)	—
	<u>\$ 41,622,995</u>	<u>\$ 38,761,399</u>	<u>\$ 2,861,596</u>	<u>\$ —</u>

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

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. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

The value of certain investments, classified as alternative investments, is determined using net asset value (or its equivalent) as a practical expedient. Investments for which the University expects to have the ability to redeem its investments with the investee within 12 months after the reporting date are categorized as Level 2. Investments for which the University does not expect to be able to redeem its investments with the investee within 12 months after the reporting date are categorized as Level 3. The University's investments in hedge funds were classified as Level 3 in the prior year. In 2013, management determined that these funds have been priced at net asset value and the University expects to have the ability to redeem its investments with the investee within 12 months after the reporting date. Accordingly, they have been restated as Level 2 investments in the 2012 table above.

***Interest Rate Swap Agreement***

The fair value is estimated using forward-looking interest rate curves and discounted cash flows that are observable or 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 University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

**Note 8: Accrued Expenses and Other Liabilities**

Accrued expenses and other liabilities at May 31, 2013 and 2012 consist of:

	2013	2012
Accrued payroll	\$ 2,946,701	\$ 2,885,095
Accrued payroll taxes and withholdings	588,851	404,987
Accrued vacation	741,979	716,827
Other accrued expenses	107,024	121,692
	\$ 4,384,555	\$ 4,128,601

**Note 9: Long-term Debt**

Long-term debt at May 31, 2013 and 2012 consists of the following:

	2013	2012
<b>Notes payable</b>		
Lines of credit	\$ 1,204,364	\$ 1,204,364
<b>Capital lease obligation</b>		
Capital lease obligation includes a ten year lease covering washer and dryer equipment used in the University's dormitories and housing facilities. The lease expires in the year 2017	109,715	126,371
<b>Bank note</b>		
Tax-exempt Qualified Revenue Note, Series of 2011, maturing at varying amounts through 2019, with interest at 1.4482% at May 31, 2013 and at variable rates thereafter that are based upon 65% of LIBOR on each reset date, plus 1.25%	8,800,000	9,600,000
<b>Bonds payable</b>		
University Revenue Refunding Bonds Series A and B of 2004, maturing at varying amounts through 2023, with interest rates ranging from 4.481% to 5.00%	8,830,000	10,050,000
University Revenue Bonds of 2008, maturing at varying amounts through 2038, with interest rates ranging from 4.25% to 5.50%	21,145,000	21,565,000
Total bonds payable	29,975,000	31,615,000
Total long-term debt	\$ 40,089,079	\$ 42,545,735

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

The University currently has two line of credit arrangements with two local banks that provide the University 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, 2015. 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 University, on parity with the Borrower's bondholders. On March 23, 2006, the University 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 University. The line of credit expires on May 31, 2015. 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, 2013 and 2012 the balances outstanding under the lines of credit were \$1,204,364.

On October 1, 2004, the University issued \$13,225,000 University Revenue Refunding Bonds, Series A of 2004 and \$5,140,000 University Revenue Refunding Bonds, Series B of 2004 (collectively, the 2004 Bonds) through the City of Erie Higher Education Building Authority (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 University 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 University issued \$21,970,000 University 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 University's Erie campus, (c) the financing of the construction of a two-story, approximately 22,000 square foot 75-bed residence hall on the University'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 University's library; (c) the renovation of McAuley Hall; (d) the construction of additional University 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.

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

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 University. Pursuant to the Agreements, the University 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 University, subject to certain permitted encumbrances, and all existing and future equipment and fixtures of the University.

On December 15, 2011, the University retired the 1999, 2001, and 2003 Variable Rate Bond Issues and issued a Tax-Exempt Revenue Note, Series of 2011 through the Authority with a local bank for the remaining outstanding principal of the three Variable Rate Bond Issues of \$9,600,000. The three Variable Rate Bond Issues funded various construction projects on the Erie and North East campuses as well as certain costs of issuing the bonds. The bank simultaneously issued the put option set forth in the note, thereby establishing the maturity date of the note at November 1, 2018. The University may request an extension of the maturity date through a written request to the bank no more than one year prior to the maturity date. Within ninety (90) days following receipt of such request, the bank shall provide the University with a written notice of its determination whether or not to extend the maturity date.

The University is subject to certain financial and reporting covenants under the 2004 and 2008 Bond issues and the 2011 Tax-Exempt Revenue Note. At May 31, 2013, the University is in compliance with these covenants.

The mandatory redemption and sinking fund requirements to redeem or otherwise retire principal amounts of the 2004 and 2008 Bonds and the 2011 Tax-Exempt Revenue Note are as follows:

- *2004 Series A Bonds* – Ranging from \$1,010,000 in 2014 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 \$255,000 in 2014 to \$345,000 in 2020, \$315,000 in 2021, \$330,000 in 2022, and \$340,000 in 2023 at maturity.
- *2008 Bonds* – Ranging from \$435,000 in 2014 to \$1,480,000 in 2038 at maturity.
- *2011 Tax-Exempt Revenue Note* – Ranging from \$800,000 in 2014 to \$3,500,000 in 2019 at maturity.

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

Aggregate annual maturities and sinking fund requirements of long-term debt and payments on capital lease obligations at May 31, 2013:

	Long-term Debt (excluding leases)	Capital Lease Obligations
2014	\$ 2,500,000	\$ 35,820
2015	3,789,364	35,820
2016	2,760,000	35,820
2017	2,845,000	35,820
2018	2,395,000	8,955
Thereafter	<u>25,690,000</u>	<u>—</u>
	<u>\$ 39,979,364</u>	152,235
Less: amount representing interest payments		<u>42,520</u>
		<u>\$ 109,715</u>

**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 University entered into an interest rate swap agreement for a portion of its floating rate debt. The agreement provides for the University 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 \$4,000,000 at May 31, 2012. Under the agreement, the University 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. The swap agreement matured November 1, 2012 and was not renewed.

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

**Note 11: Operating Leases**

The University has various operating lease agreements primarily involving facilities, office equipment and vehicles. These leases are noncancellable and expire on various dates through the year 2018.

Total rental expense for 2013 and 2012 was \$3,181,442 and \$2,557,220, respectively.

Future minimum lease payments at May 31, 2013 were:

2014	\$ 1,662,350
2015	1,224,023
2016	648,264
2017	213,320
2018	17,784
	<u>\$ 3,765,741</u>

**Note 12: Trusts Payable**

The University administers a charitable remainder trust. 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 University's use. The portion of the trust attributable to the future interest of the University is recorded in the consolidated statement 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 University's consolidated statement of financial position. On an annual basis, the University 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 trust's inception which was 7.0% and applicable mortality tables.

**Note 13: Pension Plan**

Retirement benefits are provided for University employees through the Teachers Insurance and Annuity Association University Retirement Equities Fund (TIAA-CREF) a national organization used to fund pension benefits for educational institutions. Under the arrangement, the University and plan participants make monthly contributions to TIAA-CREF to fund retirement benefits through a defined contribution plan. The plan covers a majority of all eligible employees. The University's share of the cost of these benefits for the year ended May 31, 2013 and 2012 was \$1,453,687 and \$1,323,424.

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

**Note 14: Contingencies and Commitments**

The University 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 consolidated financial position, change in net assets and cash flows of the University.

**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 are available for the following purposes or future periods:

	2013	2012
Institutional support	\$ 1,600,816	\$ 1,123,739
Instructional	1,377,711	1,116,974
Academic support	108,589	154,048
Scholarships	578,157	441,500
Plant operations	437,145	2,280,935
Public service	31,666	16,960
	\$ 4,134,084	\$ 5,134,156

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

***Permanently Restricted Net Assets***

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

	<u>2013</u>	<u>2012</u>
Institutional support	\$ 3,730,117	\$ 3,674,443
Instructional	2,315,368	2,298,832
Scholarship	10,951,255	10,701,993
Student services	108,000	108,000
Public service	62,209	62,209
	<u>\$ 17,166,949</u>	<u>\$ 16,845,477</u>

***Net Assets Released from Restriction***

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

	<u>2013</u>	<u>2012</u>
Instructional activities	\$ 53,762	\$ 85,031
Public service	—	15,000
Academic support	22,192	3,828
Student services	134,693	—
Institutional support	77,022	270,210
Operation of maintenance of plant	49,351	39,416
Scholarships	1,081,300	1,006,588
	<u>1,418,320</u>	<u>1,420,073</u>
Plant fund expenditures (non-operating)	2,137,669	31,402
	<u>\$ 3,555,989</u>	<u>\$ 1,451,475</u>

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

**Note 16: Expense Summary**

Expenses classified by natural classification are summarized as follows:

	<u>2013</u>	<u>2012</u>
Salaries and wages	\$ 33,643,009	\$ 31,874,388
Fringe benefits	10,312,138	9,415,175
Contract services	10,584,695	10,143,574
Cost of sales for auxillary enterprises	6,989,348	6,971,372
Depreciation and amortization	4,516,121	4,476,493
Rents and leases	3,181,442	2,557,220
Utilities	2,242,460	2,072,416
Travel, recruiting and athletic game expenses	2,182,108	2,192,220
Interest on indebtedness	1,849,563	1,802,580
Supplies, copying, printing and postage	1,835,717	1,827,995
Non-capital equipment	1,195,336	1,056,973
Repairs and maintenance	1,067,035	766,629
Periodicals and software	924,887	955,263
Insurance	817,343	842,324
Meetings and events	772,916	817,038
Advertising	569,877	333,980
Conferences and seminars	502,771	639,848
Bad debts	261,458	350,000
Other	2,485,409	2,335,527
	<u>\$ 85,933,633</u>	<u>\$ 81,431,015</u>

**Note 17: Functional Expenses**

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

	<u>2013</u>	<u>2012</u>
Instructional	\$ 37,722,435	\$ 35,088,197
Public service	266,670	267,593
Academic support	3,669,160	3,047,052
Student services	15,159,760	14,367,897
Institutional support	13,435,112	12,107,945
Fundraising	1,023,257	1,467,922
Auxiliary services	14,657,239	15,084,409
	<u>\$ 85,933,633</u>	<u>\$ 81,431,015</u>

**Mercyhurst University**  
**Notes to Consolidated Financial Statements**  
**May 31, 2013 and 2012**

**Note 18: Subsequent Events**

Subsequent events have been evaluated through the date of the Independent Auditor's Report, which is the date the consolidated financial statements were issued. Beginning in the fall of 2013, the University implemented a modified semester calendar with a 14 week semester in the fall, a three week intercession in January, and a 14 week semester in the spring. The financial implications of this new calendar have not been fully determined.

## **Supplementary Information**

**Mercyhurst University**  
**Schedule of Expenditures of Federal Awards**  
**Year Ended May 31, 2013**

Federal Agency/Pass-Through Entity/Cluster/Program	CFDA Number	Grant or Identifying No.	Amount
<b>Student Financial Aid Cluster</b>			
Department of Education			
Federal Work Study Program	84.033		\$ 303,760
Federal Pell Grant Program	84.063		6,582,349
Federal Supplemental Education Opportunity Grant	84.007		200,295
Federal Perkins Loan Program	84.038		2,775,567
Federal Direct Lending Program	84.268		30,083,676
Total Student Financial Aid Cluster			<u>39,945,647</u>
<b>Research and Development Cluster</b>			
Department of Commerce			
NOAA Eastern Gulf of Mexico	11.460		91,071
Department of Defense			
Artifact and Sample Analysis	12.114		9,554
Patent Pending	12.	H98230-12-C-1396	92,880
Department of the Interior			
Anasazi Basket Analysis	15.511		24,397
Draper Laboratory	15.00	SC001-550	29,512
George Mason University	15.00	E202312-5	147,259
Jacob's Strategic Solutions	15.00	S11006	124,339
Department of Labor & Industry			
<i>Pass-through from Pennsylvania</i>			
Department of Labor			
Online Course Development	17.268		19,850
National Aeronautics and Space Administration			
NASA Volcanic Processes	43.	11-PMDAP11-0024	6,673
Total Research and Development Cluster			<u>545,535</u>
<b>Workforce Investment Act Cluster</b>			
Department of Labor & Industry			
<i>Pass-through from Pennsylvania</i>			
Department of Labor			
Camp Adventures	17.259		<u>7,193</u>

**Mercyhurst University**  
**Schedule of Expenditures of Federal Awards**  
**Year Ended May 31, 2013**

Federal Agency/Pass-Through Entity/Cluster/Program	CFDA Number	Grant or Identifying No.	Amount
Department of Education			
<i>Pass-through from Pennsylvania</i>			
<i>Department of Education</i>			
Vocational Education Program	84.048	23-600-3115	151,475
Art-Based Teacher ED	84.116Z		674
Carpe Diem Academy	84.287c		680,893
Department of Labor & Industry			
<i>Pass-through from Pennsylvania</i>			
<i>Department of Labor</i>			
Trade Adjustment Assistance	17.245		104,428
Intelligence in Security & Technology	17.268		117,217
Executive Office of the President			
Office of National Drug Control Policy -			
HIDTA	95.001	G12WB0004A	4,920,918
			<u>\$ 46,473,980</u>

**Notes to Schedule**

1. This schedule includes the federal awards activity of Mercyhurst University 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 University provided \$38,057 in federal awards to Penn State Behrend, a subrecipient to the Department of Education Carpe Diem Academy Award.
3. During 2013, the University distributed \$402,047 in Perkins Loans. Perkins Loans outstanding at May 31, 2013, including the portion distributed from University funds, totaled \$ 2,463,246.
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 University to be directly applied to students' accounts. New loans processed for students during the eleven month period ended May 31, 2013 were as follows:

Federal Direct Lending Programs :	
Subsidized	\$ 10,364,290
Unsubsidized	14,602,872
PLUS	5,116,514
	<u>\$ 30,083,676</u>

**Independent Auditor's 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 University  
Erie, Pennsylvania

We have audited, 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, the consolidated financial statements of Mercyhurst University, which comprise the consolidated statement of financial position as of May 31, 2013, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 25, 2013.

***Internal Control over Financial Reporting***

Management of the University is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit, we considered the University's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control. Accordingly, we do not express an opinion on the effectiveness of the University's internal control.

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 University's consolidated financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control 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 material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses as defined above. However, material weaknesses may exist that have not been identified. We identified certain deficiencies in internal control described in the accompanying schedule of findings and responses as items 13-001 and 13-002 that we consider to be significant deficiencies in internal control.

## **Compliance**

As part of obtaining reasonable assurance about whether the University's consolidated 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 consolidated 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*.

## **Mercyhurst University's Response to Findings**

The University's response to the findings identified in our audit are described in the accompanying schedule of findings and responses. Mercyhurst University's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on it.

## **Other Matter(s)**

We noted certain matters that we reported to the University's management in a separate letter dated October 25, 2013.

The purpose of this communication is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or compliance. This communication is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*BKD, LLP*

Cincinnati, Ohio  
October 25, 2013

## Independent Auditor's 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 University  
Erie, Pennsylvania

### Report on Compliance for Each Major Federal Program

We have audited the compliance of Mercyhurst University with the types of compliance requirements described in the OMB Circular A-133 *Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended May 31, 2013. The University's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

### *Management's Responsibility*

Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the University's management.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on compliance for each of Mercyhurst University's major federal programs based on our audit of the types of compliance requirements referred to above.

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 University'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 on compliance for each major federal program. Our audit does not provide a legal determination on the University's compliance with those requirements.

### ***Opinion on Each Major Federal Program***

In our opinion, Mercyhurst University 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 year ended May 31, 2013.

### **Report on Internal Control Over Compliance**

The management of Mercyhurst University is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the University's internal control over compliance with the requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on compliance for each major federal program 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 University'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. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

*BKD, LLP*

Cincinnati, Ohio  
October 25, 2013

**Mercyhurst University**  
**Schedule of Findings and Questioned Costs**  
**Year Ended May 31, 2013**

***Summary of Auditor's Results***

1. The opinion expressed in the independent auditor's report was:  
 Unmodified     Qualified     Adverse     Disclaimer
  
2. The independent auditor's report on internal control over financial reporting described:  
Significant deficiency(ies) noted considered material weakness(es)?     Yes     None reported  
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 auditor's report on internal control over compliance with requirements applicable to major federal awards programs described:  
Significant deficiency (ies) noted considered material weakness(es)?     Yes     None reported  
Significant deficiency (ies) noted that are not considered to be a material weakness?     Yes     No
  
5. The opinion expressed in the independent auditor's report on compliance with requirements applicable to major federal awards was:  
 Unmodified     Qualified     Adverse     Disclaimer
  
6. The audit disclosed findings required to be reported by OMB Circular A-133?     Yes     No

**Mercyhurst University**  
**Schedule of Findings and Questioned Costs (continued)**  
**Year Ended May 31, 2013**

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
Carpe Diem Academy	84.287c
Office of National Drug Control Policy – HIDTA	95.001

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 University**  
**Schedule of Findings and Questioned Costs (continued)**  
**Year Ended May 31, 2013**

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

Reference Number	Finding	Questioned Costs
13-001	<p>Criteria or specific requirement – Management is responsible for establishing and maintaining effective control over financial reporting.</p> <p>Condition – A gift of property received during the year was not recorded in the general ledger.</p> <p>Context – We noted formal review and approval for certain reconciliations, journal entries and year-end close processes did not occur.</p> <p>Effect – Assets and revenues were understated and accordingly, an audit adjustment was proposed.</p> <p>Cause – It appears there was no review that gifts received were appropriately recorded in the general ledger.</p> <p>Recommendation – We recommend the Finance Office implement more formal review procedures as a control to help ensure the financial integrity of the monthly and year-end financial statements.</p> <p>Views of responsible officials and planned corrective actions –  While we believe the nature of the error noted above is such that it still would have resulted even if we had strengthened the reconciliation, journal entry, and year-end close processes, we agree that there are opportunities to enhance these processes. Specifically we are enhancing processes in two areas. We are now utilizing the accounting system’s journal entry approval process, and have established appropriate thresholds whereby supervisory personnel approve those journal entries. We are also going to continue to closely review our quarterly financial statements and document the process and results of those reviews. We will perform that same type of review on the final audited financial statements utilizing and following up on the information gathered from the quarterly reviews and document the process and the findings. In conjunction with this process, we will prepare the year-end calculations and reconciliations with a raised awareness that a more detailed explanation of variances will be required.</p>	None

**Mercyhurst University**  
**Schedule of Findings and Questioned Costs (continued)**  
**Year Ended May 31, 2013**

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

Reference Number	Finding	Questioned Costs
13-002	<p>Criteria or specific requirement – Management is responsible for establishing and maintaining effective control over financial reporting.</p> <p>Condition – Numerous non-federal outside aid account balances recorded in the general ledger were not supported by reconciliations agreeing aid drawn down or received, amounts applied to students’ accounts and amounts due to/from outside agencies.</p> <p>Context – We noted that these reconciliations did not occur during the year.</p> <p>Effect – Certain balances could be improperly recorded.</p> <p>Cause – It appears the Finance Office and Student Financial Services have not reconciled these accounts.</p> <p>Recommendation – We recommend management implement formal policies and procedures regarding timely collaboration between the Finance Office and Student Financial Services to reconcile all outside aid funds.</p> <p>Views of responsible officials and planned corrective actions –The Student Financial Services and Finance Offices meet monthly to review reconciliation progress on student related and loan receivable accounts. To date, we have had limited success in our ability to reconcile the outside aid receivable accounts. Our focus has been on the Federal Direct Lending program, which is required to be reconciled monthly. We do recognize the importance of having receivable account balances that represent legitimate, accurate and current amounts owed to the University, both from a financial accounting perspective and from a management oversight perspective. During the coming year we will prioritize the outside aid receivable accounts and begin to establish the regular monthly reconciliation processes so that all receivable balances remain up to date.</p>	None

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

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

No matters are reportable.

**Mercyhurst University**  
**Summary Schedule of Prior Audit Findings**  
**Year Ended May 31, 2013**

<b>Reference Number</b>	<b>Summary of Finding</b>	<b>Status</b>
-----------------------------	---------------------------	---------------

---

No matters are reportable.