



**The Pennsylvania Higher Education Foundation, Inc.**

**Consolidated Annual Financial Report**

**May 31, 2007**



**KPMG LLP**  
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PO Box 1190  
Harrisburg, PA 17108-1190

## **Independent Auditors' Report**

The Board of Directors  
The Pennsylvania Higher Education Foundation, Inc.:

We have audited the accompanying consolidated statements of financial position of The Pennsylvania Higher Education Foundation, Inc. (the Foundation) as of May 31, 2007 and 2006, and the related consolidated statements of activities, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Foundation's management. 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. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Pennsylvania Higher Education Foundation, Inc. as of May 31, 2007 and 2006, and the results of its activities and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

September 25, 2007

**The Pennsylvania Higher Education Foundation, Inc.**  
 Consolidated Statements of Financial Position  
 As of May 31



	2007	2006
<b>Assets:</b>		
Cash	\$ 155,323	25,230
Short-term investments	84,912	108,716
Accounts receivable	18,100	-
Prepaid expenses	14,036	13,963
Contributions receivable, net of discount	5,961,808	4,733,248
Long-term investments	42,860,915	39,606,773
Office furnishings and equipment, net of accumulated depreciation	66,891	90,543
<b>Total assets</b>	<b>\$ 49,161,985</b>	<b>44,578,473</b>
<b>Liabilities and net assets:</b>		
<b>Liabilities:</b>		
Accrued expenses	\$ 320,297	395,059
Grants payable	2,687,264	200,897
Amounts payable to specific organizations as designated by donors	196,090	583,334
<b>Total liabilities</b>	<b>3,203,651</b>	<b>1,179,290</b>
<b>Net assets:</b>		
Unrestricted	266,327	140,755
Temporarily restricted	45,692,007	43,258,428
<b>Total net assets</b>	<b>45,958,334</b>	<b>43,399,183</b>
<b>Total liabilities and net assets</b>	<b>\$ 49,161,985</b>	<b>44,578,473</b>

See accompanying notes to consolidated financial statements.

**The Pennsylvania Higher Education Foundation, Inc.**  
Consolidated Statements of Activities  
For the years ended May 31



	2007	2006
Changes in unrestricted net assets:		
Revenues:		
Income on long-term investments	\$ 53,388	20,842
Net unrealized and realized gains on long-term investments	72,184	60,709
Total revenues	125,572	81,551
Net assets released from restrictions	20,061,189	17,971,652
Increase in unrestricted net assets	20,186,761	18,053,203
Expenses:		
Program services:		
Nursing Education Initiative		
Grants	16,064,791	11,683,859
Other program services	2,519,400	4,951,095
Total program services	18,584,191	16,634,954
Management and general	1,063,206	993,968
Fundraising	413,792	342,730
Total expenses	20,061,189	17,971,652
Net change in unrestricted net assets	125,572	81,551
Changes in temporarily restricted net assets:		
Contributions	16,562,362	19,438,955
Income on short-term investments	1,222	3,771
Income on long-term investments	1,302,143	878,289
Net unrealized and realized gains on long-term investments	4,629,041	2,671,411
Net assets released from restrictions	(20,061,189)	(17,971,652)
Increase in temporarily restricted net assets	2,433,579	5,020,774
Increase in net assets	2,559,151	5,102,325
Net assets at beginning of year	43,399,183	38,296,858
Net assets at end of year	\$ 45,958,334	43,399,183

See accompanying notes to consolidated financial statements.

**The Pennsylvania Higher Education Foundation, Inc.**  
Consolidated Statements of Cash Flows  
For the years ended May 31



	2007	2006
Cash flows from operating activities:		
Cash received from donors	\$ 12,678,441	11,441,792
Investment income received	1,356,753	902,902
Grants paid	(14,033,768)	(12,918,795)
Cash paid for other program services, management and general, and fundraising expenses	(1,342,220)	(2,006,569)
Net cash used for operating activities	(1,340,794)	(2,580,670)
Cash flows from investing activities:		
Proceeds from sales or maturities of long-term investments	75,906,475	65,401,121
Purchases of long-term investments	(74,459,392)	(62,876,168)
Proceeds from sales or maturities of short-term investments	325,027	555,044
Purchases of short-term investments	(301,223)	(474,971)
Net cash provided by investing activities	1,470,887	2,605,026
Net change in cash	130,093	24,356
Cash at beginning of year	25,230	874
Cash at end of year	\$ 155,323	25,230
Reconciliation of change in net assets to net cash provided by operating activities:		
Change in net assets	\$ 2,559,151	5,102,325
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Depreciation	23,652	23,486
Net unrealized gains on long-term investments retained	(2,661,516)	(1,441,617)
Net realized gains on sales of long-term investments	(2,039,709)	(1,290,503)
Increase in contributions receivable, net of discount	(1,228,560)	(4,713,539)
Increase in prepaid expenses	(73)	(8,135)
Increase in accounts receivable	(18,100)	-
Increase (decrease) in accrued expenses	(74,762)	67,184
Increase in grants payable	2,486,367	200,897
Decrease in amounts payable to specific organizations as designated by donors	(387,244)	(519,166)
Gifts of office furnishings and equipment	-	(1,602)
Net cash used for operating activities	\$ (1,340,794)	(2,580,670)

See accompanying notes to consolidated financial statements.



## **1. Organization and Operation**

The Pennsylvania Higher Education Foundation, Inc. (“PHEF” or the “Foundation”), a not-for-profit organization, was formed on June 22, 2001. Its charitable purposes include, but are not limited to, activities intended to improve or enhance postsecondary educational opportunities for students in Pennsylvania and elsewhere. It may fulfill its purposes by assisting students in meeting their expenses of higher education by providing assistance in the form of grants, loans, or scholarships. It may also enable educational institutions that offer postsecondary programs and lenders to make loans or other financial assistance available to students and parents for postsecondary educational purposes and by providing such other assistance to students, parents, and educational institutions as will improve or enhance postsecondary educational opportunities.

Pennsylvania Higher Education Assistance Agency (“PHEAA”), a component unit of the Commonwealth of Pennsylvania, supported the formation of the Foundation and paid for the costs of creating the Foundation. The Foundation is tax-exempt under Section 501(c)(3) of the Internal Revenue Code.

## **2. Related Entity and Related Party Transactions**

A majority of the directors of the Foundation are also members of PHEAA’s Executive Committee. As such, transactions between PHEAA and the Foundation are related party transactions.

During the year ended May 31, 2007, PHEAA made a cash donation of \$10,000,000. Additionally, PHEAA provided donated services valued at \$2,705,361. During the year ended May 31, 2006, PHEAA made a cash donation of \$10,000,000. Additionally, PHEAA provided donated services valued at \$4,198,689 and gifts of office furnishings and equipment valued at \$1,602. The donated services and gifts of office furnishings and equipment that PHEAA provided to the Foundation were valued at PHEAA’s actual cost and reported as contribution revenue and as assets or expenses in the financial statements. All support provided by PHEAA is classified as temporarily restricted gifts since the donations are restricted to PHEAA’s statutory purpose.

PHEAA has also made a non-binding commitment to support future operations of the Foundation by transferring up to an additional \$30,000,000 before June 30, 2009. On June 21, 2007, PHEAA made a cash donation of \$10,000,000 to the Foundation, reducing this amount to \$20,000,000. Additionally, PHEAA may support the operations of the Foundation by donating operational and system support. PHEAA may decline to donate at any time if it determines that making such donations would not be in its best interests. Because the commitment is non-binding and undetermined, a contribution receivable has not been recorded in the accompanying consolidated financial statements.



### **3. Summary of Significant Accounting Policies**

(a) Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and are presented pursuant to Financial Accounting Standards Board Statement No. 117, *Financial Statements of Not-for-Profit Organizations*.

(b) Consolidation

The consolidated financial statements include the accounts of PHEF and The Higher Education Foundation, Inc., ("HEF") a not-for-profit organization. HEF was also formed on June 22, 2001, and its charitable purpose is to operate exclusively for the benefit of PHEF and the directors of PHEF are directors of HEF. HEF was formed to assist with fundraising and program administration particularly for projects that may extend beyond Pennsylvania. All significant intercompany transactions and balances are eliminated in consolidation.

(c) Investments

Investments include equity, fixed income and money market securities and are reported at fair value.

(d) Office Furnishings and Equipment

Office furnishings and equipment are reported at cost, net of depreciation. Depreciation is calculated on the straight-line method over the estimated useful life of the asset. Estimated useful lives of office furnishings and equipment range from 3 to 25 years.

(e) Donor-restricted contributions

Contributions that are restricted by the donor are reported as increases in temporarily or permanently restricted net assets, depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as temporarily restricted net assets and reclassified to unrestricted net assets in the statement of activities as net assets released from restriction.

(f) Functional Allocation of Expenses

The costs of supporting the programs and other activities have been summarized on a functional basis in the consolidated statements of activities. Expenses have been classified based upon the actual direct expenditures and cost allocations based upon estimates of time spent by Foundation personnel.

(g) 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 certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.



#### 4. Net Assets

The Foundation classifies its net assets into three categories as follows:

- Permanently restricted – net assets subject to donor-imposed stipulations that the net assets be maintained permanently by the Foundation.
- Temporarily restricted – net assets resulting from contributions and other inflows of assets whose use is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions pursuant to those stipulations.
- Unrestricted – Net assets that are neither permanently restricted nor temporarily restricted by donor-imposed stipulations.

Net assets at May 31, 2007 and 2006 consist of the following:

	2007	2006
Unrestricted	\$ 266,327	140,755
Temporarily restricted:		
Nursing Education Initiative	6,929,440	5,205,837
PHEAA's statutory purpose	38,762,567	38,052,591
Total temporarily restricted	45,692,007	43,258,428
Total net assets	\$ 45,958,334	43,399,183

The Foundation created the Nursing Education Initiative to provide a new source of financial support to schools and students. The intent of the program is to encourage additional students to pursue nursing as an academic and professional choice. PHEAA's statutory purpose is to improve the higher education opportunities for Pennsylvanians.

#### 5. Tax Status

The Internal Revenue Service ("IRS") has determined and informed the Foundation by a letter dated August 8, 2001 that the Foundation is exempt from federal income tax under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3). The initial determination of the Foundation's tax status was to expire on May 31, 2006; however, by letter dated September 30, 2005, the IRS issued a final determination confirming the Foundation's status as a publicly supported organization.



## 6. Investments and Investment Income

Investments at May 31, 2007 and 2006 were as follows:

	2007	2006
Short-term:		
Savings account	\$ 84,912	108,716
Long-term:		
Equity mutual funds	13,759,104	9,333,589
Equity investments	13,176,210	17,280,294
Fixed income funds	11,629,850	10,950,921
Cash and money market securities	4,295,751	2,041,969
	<u>42,860,915</u>	<u>39,606,773</u>
	<u>\$ 42,945,827</u>	<u>39,715,489</u>

Investment income for the years ended May 31, 2007 and 2006 were as follows:

	2007	2006
Short-term:		
Interest	\$ 1,222	3,771
Long-term:		
Interest and dividends	1,355,531	899,131
Net unrealized and realized gains	4,701,225	2,732,120
	<u>6,056,756</u>	<u>3,631,251</u>
	<u>\$ 6,057,978</u>	<u>3,635,022</u>

## 7. Contributions Receivable

Contributions receivable at May 31, 2007 and 2006 consist of the following:

	2007	2006
Due within one year	\$ 2,850,000	2,010,000
Due in one to three years	<u>3,350,000</u>	<u>3,000,000</u>
	6,200,000	5,010,000
Less unamortized discount	<u>(238,192)</u>	<u>(276,752)</u>
	<u>\$ 5,961,808</u>	<u>4,733,248</u>

Contributions of unconditional promises to give are recognized as revenue when written agreements are signed or follow-up written confirmations are received. All unconditional promises to give are considered fully collectible; accordingly, no allowance for uncollectible pledges has been recorded. For the years ended May 31, 2007 and 2006, unconditional promises to give due beyond one year have been recorded at the present value of their estimated future cash flows using a discount rate ranging from 5 percent to 5.25 percent.



### 8. Office Furnishings and Equipment

Office furnishings and equipment at May 31, 2007 and 2006 were as follows:

	2007	2006
Office furnishings and equipment	\$ 120,186	120,186
Vehicle	41,628	41,628
Software	413	413
	<u>162,227</u>	<u>162,227</u>
Less accumulated depreciation	<u>(95,336)</u>	<u>(71,684)</u>
	<u>\$ 66,891</u>	<u>90,543</u>

### 9. Agency Transactions

The Foundation receives donations for which the donor is involved in directing the donation to specified organizations that qualified for Foundation programs. Accordingly, these transactions are considered agency transactions, the donated amount is recorded as a liability in the consolidated statement of financial position, and the Foundation did not recognize contribution revenue and will not recognize a program expense when the donations are transferred to the recipients.

Amounts payable to specific organizations as designated by donors at May 31, 2007 and 2006 were as follows:

	2007	2006
Balance at beginning of period	\$ 583,334	1,102,500
Donations received	50,000	916,667
Less donations transferred to specific organizations	<u>(437,244)</u>	<u>(1,435,833)</u>
Balance at end of period	<u>\$ 196,090</u>	<u>583,334</u>

For the agency transactions, the Foundation has committed to providing matching funds to donations within the Nursing Assistance Program based on a percentage of the amount donated to the Nursing Education Grant Program. For the years ended May 31, 2007 and 2006, the Foundation provided matching funds of \$99,583 and \$228,333, respectively. These amounts are recognized as expenses within the consolidated statements of financial position when the recipients have been identified.

### 10. Defined Contribution Pension Plan

The Foundation has a defined contribution pension plan. The Foundation's contribution is based on a percentage of salary. The pension plan expense for the years ended May 31, 2007 and 2006 were \$14,912 and \$15,000, respectively.



## **11. Commitments and Contingencies**

For the 2007-08 program year, the Foundation has received approximately 125 applications and grant proposals that, if approved by the Board of Directors, will result in grants related to the Nursing Education Initiative of approximately \$12,000,000. This amount may also include donor contributions to the Nursing Education Grant Program and the various donor component programs within the Pennsylvania Nursing Assistance Program. Assuming approval, the Foundation expects that these grants will be paid by May 31, 2008. In addition, the Foundation has committed up to \$2,250,000 in matching funds for the 2007-08 academic year to encourage other organizations and individuals to provide scholarship funds for nursing students and \$1,000,000 for a career awareness campaign.

In June 2005, the board of directors adopted a resolution authorizing an amount up to \$40,000,000 over a four year period ending June 1, 2009 for the Nursing Education Capacity Initiatives. These amounts will be used to address the Commonwealth's nursing shortage by providing financial aid with a specific view towards increasing nursing school capacity and the number of students who are able to seek a graduate degree program in nursing and are contingent upon the availability of funds. Through May 31, 2007, the Foundation provided \$11,450,044 in financial aid related to this initiative.