



The Pennsylvania Higher Education Foundation, Inc.

Consolidated Annual Financial Report

May 31, 2009



KPMG LLP
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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. as of May 31, 2009 and 2008, 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, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

August 23, 2009

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



	2009	2008
Assets:		
Cash	\$ 315,415	21,512
Short-term investments	277,123	358,733
Accounts receivable	-	48
Prepaid expenses	4,440	12,766
Contributions receivable, net of discount	2,300,000	4,777,440
Long-term investments	21,382,103	37,901,130
Office furnishings and equipment, net of accumulated depreciation	46,049	53,152
Total assets	\$ 24,325,130	43,124,781
Liabilities and net assets:		
Liabilities:		
Accrued expenses	\$ 312,520	273,334
Grants payable	5,637,235	2,348,598
Amounts payable to specific organizations as designated by donors	91,563	91,563
Total liabilities	6,041,318	2,713,495
Net assets:		
Unrestricted	374,437	323,447
Temporarily restricted	17,909,375	40,087,839
Total net assets	18,283,812	40,411,286
Total liabilities and net assets	\$ 24,325,130	43,124,781

See accompanying notes to consolidated financial statements.

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



	2009	2008
Changes in unrestricted net assets:		
Revenues:		
Income on long-term investments	\$ 44,307	47,372
Net unrealized and realized gains on long-term investments	6,683	9,748
Total revenues	50,990	57,120
Net assets released from restrictions	19,952,812	19,046,529
Increase in unrestricted net assets	20,003,802	19,103,649
Expenses:		
Program services:		
Nursing Education Initiative		
Grants	17,630,730	15,587,821
Other program services	1,236,805	1,864,122
Total program services	18,867,535	17,451,943
Management and general	811,483	1,138,257
Fundraising	273,794	456,329
Total expenses	19,952,812	19,046,529
Net change in unrestricted net assets	50,990	57,120
Changes in temporarily restricted net assets:		
Contributions	512,029	12,843,886
Income on short-term investments	3,415	3,852
Income on long-term investments	856,086	1,108,198
Net unrealized and realized losses on long-term investments	(2,097,182)	(513,575)
Loss from write off of contributions receivable	(1,500,000)	-
Net assets released from restrictions	(19,952,812)	(19,046,529)
Decrease in temporarily restricted net assets	(22,178,464)	(5,604,168)
Decrease in net assets	(22,127,474)	(5,547,048)
Net assets at beginning of year	40,411,286	45,958,334
Net assets at end of year	\$ 18,283,812	40,411,286

See accompanying notes to consolidated financial statements.

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



	2009	2008
Cash flows from operating activities:		
Cash received from donors	\$ 1,094,250	11,872,903
Investment income received	893,912	1,159,422
Grants paid	(14,342,045)	(16,062,914)
Cash paid for other program services, management and general, and fundraising expenses	(1,872,057)	(1,285,096)
Net cash used for operating activities	(14,225,940)	(4,315,685)
Cash flows from investing activities:		
Proceeds from sales or maturities of long-term investments	81,634,064	72,497,102
Purchases of long-term investments	(67,195,641)	(68,041,144)
Proceeds from sales or maturities of short-term investments	1,085,026	630,030
Purchases of short-term investments	(1,003,415)	(903,852)
Net cash provided by investing activities	14,520,034	4,182,136
Cash flows from financing activities		
Purchases of office furnishings and equipment	(191)	(262)
Net cash used for financing activities	(191)	(262)
Net change in cash	293,903	(133,811)
Cash at beginning of year	21,512	155,323
Cash at end of year	\$ 315,415	21,512
Reconciliation of change in net assets to net cash provided by operating activities:		
Change in net assets	\$ (22,127,474)	(5,547,048)
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Depreciation	7,294	24,157
Loss from write off of contributions receivable	1,500,000	-
Net unrealized losses on long-term investments retained	1,483,407	3,413,057
Net realized losses (gains) on sales of long-term investments	607,092	(2,909,229)
Increase in investment income receivable	(9,896)	-
Decrease in contributions receivable, net of discount	977,440	1,184,368
Decrease in prepaid expenses	8,326	1,270
Decrease in accounts receivable	48	18,052
Increase (decrease) in accrued expenses	39,186	(46,963)
Increase (decrease) in grants payable	3,288,637	(338,666)
Decrease in amounts payable to specific organizations as designated by donors	-	(104,527)
Gifts of office furnishings and equipment	-	(10,156)
Net cash used for operating activities	\$ (14,225,940)	(4,315,685)

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, 2009, the Foundation board of directors adopted a resolution to transfer \$3,000,000 to PHEAA to be used to purchase student loans in the Interim Loan Program for Nursing Students. This program assists students going to nursing school by providing a private PHEAA loan, mirroring Stafford loan limits, until the nursing school receives Title IV loan eligibility. The Foundation had previously agreed to guarantee these loans up to \$2,000,000. This resolution extended another \$1,000,000 for this program, as well as providing funding for the full \$3,000,000.

During the year ended May 31, 2009, PHEAA provided donated services valued at \$395,219. During the year ended May 31, 2008, PHEAA made a cash donation of \$10,000,000. Additionally, PHEAA provided donated services valued at \$2,195,195 and gifts of office furnishings and equipment valued at \$10,156. The donated services 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.

Previously, PHEAA had 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 supported the operations of the Foundation by donating operational and system support. PHEAA retained the ability to decline to donate at any time if it determined that making such donations would not be in its best interest.

On January 24, 2008, as a result of financial constraints, the PHEAA board of directors adopted a resolution changing this non-binding commitment by discontinuing the annual cash donations and reducing the amount provided for ongoing operational support to not exceed \$300,000 annually through May 31, 2012 and thereafter until further action of the board.

On April 23, 2009, the PHEAA board of directors adopted a resolution repealing certain sections of the resolution adopted on January 24, 2008. This resolution repealed the \$300,000 restriction on the amount of operation support that could be provided by PHEAA to the Foundation on an annual basis. However, no actions were taken to reinstitute any future cash contributions to the Foundation.



3. Future Plan and Actions

It is the intention of the Foundation to continue to provide grants awards for as long as funds remain available to do so. As of the date of this report, the Foundation anticipates that sufficient funds will be available to award grants through the May 31, 2011 fiscal year. While the anticipated awards in 2009-10 and 2010-11 are expected to be less than 2008-09, these awards have not been approved by the Foundation board and are subject to change. It is the intention of Foundation management and the Board to manage the grant awards so that all approved awards can be fully disbursed and all administrative expenses can be paid in full. Since the board has full discretion over the amount awarded, the Foundation does not anticipate a scenario in which approved awards or incurred administrative expenses would remain unpaid due to a lack of funds.

4. 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. During the years ended May 31, 2009 and 2008, HEF had no financial transactions.

(c) Investments

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

(d) Fair Value Measurements

On June 1, 2008, the Foundation adopted the provisions of FASB Statement No. 157, *Fair Value Measurements* (Statement 157), for fair value measurements of financial assets and financial liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. Statement 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Statement 157 also establishes a framework for measurement of fair value and expands disclosures about fair value measurements. The adoption of SFAS 157 had no impact on the financial statements.

On June 1, 2009, the Foundation will be required to apply the provisions of Statement 157 to fair value measurements of nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Foundation will not be impacted by the adoption of these provisions.

(e) 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.



(f) 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.

(g) 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.

(h) 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.

(i) Reclassifications

Certain prior year amounts have been reclassified to conform to the current year's presentation.

5. 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, 2009 and 2008 consist of the following:

	2009	2008
Unrestricted	\$ 374,437	323,447
Temporarily restricted:		
Nursing Education Initiative	3,344,306	6,549,757
PHEAA's statutory purpose	14,565,069	33,538,082
Total temporarily restricted	17,909,375	40,087,839
Total net assets	\$ 18,283,812	40,411,286



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.

6. 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.

On December 30, 2008, the FASB issued FASB Staff Position (FSP) No. FIN 48-3 that deferred for an additional year the effective date of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), for certain nonpublic entities within the scope of the FSP. The new effective date is for fiscal years beginning after December 15, 2008. The Foundation has elected to defer the application of FIN 48 until June 1, 2009 in accordance with the FSP. The Foundation's current accounting policy for evaluating uncertain tax positions is to recognize the effect of income tax positions only if such positions are probable of being sustained.

7. Investments and Investment Income

Investments at May 31, 2009 and 2008 were as follows:

	2009	2008
Short-term:		
Savings accounts	\$ 277,123	358,733
Long-term:		
Equity mutual funds	954,246	16,312,531
Equity investments	-	9,626,710
Fixed income funds	15,494,176	9,977,107
Cash and money market securities	4,933,681	1,984,782
	<u>21,382,103</u>	<u>37,901,130</u>
	<u>\$ 21,659,226</u>	<u>38,259,863</u>

Investment income for the years ended May 31, 2009 and 2008 were as follows:

	2009	2008
Short-term:		
Interest	\$ 3,415	3,852
Long-term:		
Interest and dividends	900,393	1,155,570
Net unrealized and realized gains (losses)	(2,090,499)	(503,827)
	<u>(1,190,106)</u>	<u>651,743</u>
	<u>\$ (1,186,691)</u>	<u>655,595</u>

8. Fair Value Measurements

The Foundation adopted Statement 157 on June 1, 2008 for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The fair value of a financial instrument is the amount 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 assuming the transaction occurs in the entity's principle (or most advantageous) market.

The fair values of the Foundation's financial instruments represent management's best estimates of the amounts that would be received to sell those assets or that would be paid to transfer those liabilities in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Foundation's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Foundation based on the best information available in the circumstances.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

- Cash, short-term investments, prepaid expenses, accrued expenses, and grants payable: The carrying amounts approximate fair value because of the short maturity of these instruments.
- Contributions receivable: The fair value is determined as the present value of future cash flows discounted at an interest rate that reflects the risks inherent in those cash flows. The carrying value of contributions receivable at May 31, 2009 represents the fair value as the remaining receivable is expected to be collected within one year.
- Long-term Investments: The fair value of fixed income securities, common stock and equity mutual and other funds are determined using quoted market prices at the reporting date multiplied by the quantity on hand. The carrying amount of money market funds approximates the fair value because of the short maturity of these investments.

Statement 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quote prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1: Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities that are traded in an active exchange market.
- Level 2: Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quotes 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 2 assets and liabilities include debt securities with quoted market prices that are traded less frequently than exchange traded instruments.
- Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes private equity and limited partnership interests.



The following table presents assets and liabilities that are measured at fair value on a recurring basis as of May 31, 2009:

	Fair Value	Level 1	Level 2	Level 3
Financial Assets:				
Investments:				
Equity mutual funds	\$ 954,246	954,246	-	-
Equity investments	-	-	-	-
Fixed income funds	15,494,176	15,494,176	-	-
Cash and money market securities	4,933,681	4,933,681	-	-
	<u>\$ 21,382,103</u>	<u>21,382,103</u>	<u>-</u>	<u>-</u>

9. Contributions Receivable

Contributions receivable at May 31, 2009 and 2008 consist of the following:

	2009	2008
Due within one year	\$ 2,300,000	3,350,000
Due in one to three years	-	1,500,000
	<u>2,300,000</u>	<u>4,850,000</u>
Less unamortized discount	-	(72,560)
	<u>\$ 2,300,000</u>	<u>4,777,440</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. However, during the year ended May 31, 2009, one unconditional promise to give in the amount of \$1.5 million was revoked by the donor. The \$1.5 million was written off as uncollectible during the year. For the year ended May 31, 2009, there are no unconditional promises to give that are due beyond one year. For the year ended May 31, 2008, 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.

10. Office Furnishings and Equipment

Office furnishings and equipment at May 31, 2009 and 2008 were as follows:

	2009	2008
Office furnishings and equipment	\$ 130,342	130,342
Vehicle	41,628	41,628
Software	865	675
	<u>172,835</u>	<u>172,645</u>
Less accumulated depreciation	(126,786)	(119,493)
	<u>\$ 46,049</u>	<u>53,152</u>



11. Agency Transactions

The Foundation receives donations for which the donor is involved in directing the donation to specified organizations that qualify 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 does 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, 2009 and 2008 were as follows:

		2009	2008
Balance at beginning of period	\$	91,563	196,090
Donations received		-	50,000
Less donations transferred to specific organizations		-	(154,527)
Balance at end of period	\$	91,563	91,563

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. These amounts are recognized as expenses within the consolidated statements of financial position when the recipients have been identified. For the years ended May 31, 2009 and 2008, the Foundation did not provide any matching funds.

12. 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, 2009 and 2008 were \$15,000.

13. Commitments and Contingencies

For the 2009-10 program year, the Foundation has received approximately 124 applications and grant proposals that, if approved by the Board of Directors, will result in grants related to the Nursing Education Initiative of approximately \$7,000,000. 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, 2010. In addition, the Foundation has committed up to \$2,250,000 in matching funds for the 2009-10 academic year to encourage other organizations and individuals to provide scholarship funds for nursing students.

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, 2009, the Foundation provided \$24,039,389 in financial aid related to this initiative.